Supreme Court, U.S.
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No. 98 799

In The

Supreme Court of the United States

October Term, 1998

KAUTHAR SDN BHD,

Petitioner,

vs.

MICHAEL A. STERNBERG, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In 1991, this Court recognized that Section 9(e) of the Securities Exchange Act of 1934 (15 U.S.C. § 78i(e)) governs the limitations period for claims brought under Section 10(b) (15 U.S.C. § 78j) and Rule 10b-5 (17 C.F.R. § 240.10b-5 (1998)). *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991). Many of the United States Courts of Appeals are now applying a standard for calculating the time when this one-year statute of limitations begins to run that is contrary to this Court's decision in *Lampf* and the express language of Section 9(e). The questions presented are:

1. Whether the one-year statute of limitations period for private civil actions for damages under Section 10(b) and Rule 10b-5 as set forth in Section 9(e) of the Securities Exchange Act of 1934 begins to run from the time the victim of the fraud becomes aware that he or she is in fact a victim of fraud (*i.e.*, actual notice) rather than the time the victim becomes aware of facts that would lead a reasonable person to investigate whether he or she might have been a victim of fraud (*i.e.*, inquiry notice).

2. Whether a plaintiff's Section 10(b) and Rule 10b-5 securities fraud claims predicated upon several distinct and unrelated misrepresentations and omissions should be dismissed in their entirety with prejudice as time-barred under the one-year limitations period applicable to such claims when the plaintiff had notice of only one of the several misrepresentations and omissions underlying its claims more than one year prior to the time that it filed suit.

3. Whether this Court should exercise its supervisory powers and remand this case to the circuit court

for consideration of the viability of certain state law securities claims because the circuit court rejected one of the grounds upon which the district court based its decision to dismiss those claims, expressly did not consider the other grounds, and nonetheless affirmed the district court's dismissal of those claims without addressing them or providing any basis in its opinion for sustaining their dismissal.

LIST OF PARTIES

The following is a list of all of the parties before the court of appeals and before this Court: Kauthar Sdn Bhd, Michael A. Sternberg, James A. Simon, Carl B. Hilliard, Jr., Dr. Matt C. Nilson, Friendly Islands Satellite Communications, Ltd., d/b/a Tongasat, Larry L. Risser, W.L. Pritchard & Co., Inc., Sharon E. Hilliard, Denise Simon, Nilson Research Corporation, Jerry J. Fletcher, and Her Royal Highness Princess Salote Mafileo Pilolevu Tuita.

RULE 29.6 LISTING

Kauthar Sdn Bhd does not have a corporate parent. ZL Construction Sdn Bhd is a nonwholly owned subsidiary of Kauthar Sdn Bhd.

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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1998

KAUTHAR SDN BHD, *Petitioner,*

v.

MICHAEL A. STERNBERG, *et al.*, *Respondents.*

Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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Kauthar Sdn Bhd respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

CITATIONS OF OPINIONS AND ORDERS

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at *Kauthar Sdn Bhd v. Sternberg*, 149 F.3d 659 (7th Cir. 1998) and is reprinted in Appendix A, pages 1a-30a to this Petition. The opinion and Order of Final Judgment of the United States District Court for the Northern District of Indiana in *Kauthar Sdn Bhd v. Sternberg*, No. 1:95cv199 (N.D. Ind. Apr. 14, 1997; June 24, 1997) is set forth in five separate orders and

is not published, but is reprinted in Appendices C-F, and I, pages 33a-125a, 130a to this Petition.

BASIS FOR JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on July 14, 1998. The United States Court of Appeals for the Seventh Circuit denied a timely petition for rehearing on August 12, 1998. The United States Court of Appeals for the Seventh Circuit denied petitioner's motion to recall mandate and for clarification by order entered on September 23, 1998. This Court has not granted an extension of time to file this Petition for Writ of Certiorari. This Court has jurisdiction to review the judgment in question on a writ of certiorari pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND REGULATIONS INVOLVED

This case involves Sections 10(b) and 9(e) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j and 78i(e), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1998). Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange:
>
> (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any

> security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j.

Section 9(e) provides in pertinent part:

> No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

15 U.S.C. § 78i(e).

Rule 10b-5 provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of

> the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1998).

STATEMENT OF THE CASE

This case presents important and fundamental questions concerning the circumstances under which a victim's federal securities fraud claim may be dismissed at the pleading stage on statute of limitations grounds. Certain circuit courts, including the Seventh Circuit, have ignored the plain language of Section 9(e) and this Court's decision in *Lampf* in applying an "inquiry notice" standard to determine when the statute of limitations begins to run on Section 10(b) and Rule 10b-5 claims. Consequently, a number of lower courts have denied relief to victims of

securities fraud on statute of limitations grounds in circumstances in which neither Congress nor this Court intended to bar a victim's remedy.

This case also raises the question of whether a plaintiff's Section 10(b) and Rule 10b-5 claims should be dismissed in their entirety with prejudice merely because the plaintiff may have had notice more than one year prior to filing suit that one of the several unrelated misrepresentations and omissions underlying the claims may have been untrue. The circuit court in this case affirmed the dismissal of the plaintiff's federal securities fraud claims, with prejudice, on statute of limitations grounds, because it concluded that the plaintiff's complaint showed that the plaintiff was on notice more than one year prior to filing its complaint of one potential aspect of the defendants' fraud. There was nothing else in the complaint or record that indicated that the plaintiff was on inquiry or actual notice concerning any of the several other separate, distinct, and unrelated misrepresentations and omissions that formed the basis of the plaintiff's claims such that claims based upon those misrepresentations and omissions would be time-barred. Nonetheless, as a consequence of the circuit court's decision in this case, the plaintiff has been denied an opportunity to bring a claim based upon any of the several unrelated misrepresentations and omissions of which it had no inquiry or actual notice more than a year prior to the time that it filed its complaint.

Finally, this case warrants this Court's assertion of its supervisory powers because the circuit court failed to fulfill its obligation to consider an issue that was a subject of the appeal. The circuit court expressly rejected one of the grounds upon which the district court based its decision to dismiss the plaintiff's state law securities fraud claims, and

expressly did not reach the other grounds upon which the dismissal was based. Indeed, the circuit court did not even mention the plaintiff's state law securities fraud claims in its opinion. Nonetheless, the circuit court affirmed the dismissal of those claims. This Court's supervisory powers should be exercised in such a circumstance to ensure that a plaintiff receives due process consideration of the all of the claims that it has asserted.

A. Factual Background.

This case arises from a $38 million investment that the plaintiff, Kauthar Sdn Bhd, a Malaysian corporation with its principal place of business in Malaysia, made in Rimsat, Inc. ("Rimsat"), a Nevis corporation with its principal place of business in Fort Wayne, Indiana. Rimsat was to provide satellite communication services to customers in the Pacific Rim region from satellites that were to be purchased from Russian entities (the "Russian Entities"). The satellites were to be placed into geosynchronous orbit positions ("GSOs") leased to Rimsat by a corporation ("Tongasat") that was formed in and by the Pacific Rim Kingdom of Tonga.

Due to the limited number of available GSOs—satellites cannot be put in too close proximity to each other without creating communications interference—GSOs are valuable and difficult to obtain. They are regulated and must be registered with agencies of the United Nations, and only sovereign nations may apply for the right to a GSO.

The defendants' plan for Rimsat was to purchase inexpensive satellites from the Russian Entities, lease GSOs from the Kingdom of Tonga's company, Tongasat, and sell satellite communications services. They then convinced the

plaintiff and others to make substantial capital investments in Rimsat. However, in January 1995, several of Rimsat's creditors placed Rimsat into bankruptcy through the filing of an involuntary bankruptcy petition in the United State Bankruptcy Court for the Northern District of Indiana.

Shortly thereafter, on March 10, 1995, the plaintiff filed suit. The crux of all of the plaintiff's claims was that the parties that had solicited its investment in Rimsat intentionally misled the plaintiff about the investment.

B. The First Amended Complaint.

The plaintiff filed its First Amended Complaint ("Amended Complaint") on September 28, 1995, asserting twenty-two causes of action, including federal and Indiana state law securities fraud claims, arising from numerous misrepresentations and omissions made by the defendants to induce its investment in Rimsat. The 133-page Amended Complaint detailed the manner in which the defendants defrauded the plaintiff and other investors over a period of nearly three years beginning in May 1992. The misrepresentations and omissions underpinning the plaintiff's claims concerned several distinct and unrelated subjects: the Rimsat/Tongasat contract; the Rimsat/Russian Entities contract; the status of the GSOs; the prospectus circulated by the defendants; the undisclosed inter-relationship between Rimsat/Tongasat and their principals; Rimsat's use of invested capital; and Rimsat's general business plan, organization and set-up.

C. The Proceedings Below.

The district court in a series of orders dismissed the plaintiff's state and federal securities fraud claims on

grounds that the court lacked subject matter jurisdiction to adjudicate those claims, that certain of the federal securities fraud claims were barred by the one-year statute of limitations applicable to such claims, and that the claims were not pleaded with sufficient particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure. The district court also granted summary judgment in the defendants' favor on standing grounds, finding that the plaintiff was not the purchaser of the securities.

On appeal, the circuit court rejected the district court's conclusion that the district court lacked subject matter jurisdiction to adjudicate those claims. It specifically avoided consideration of the issue of whether the plaintiff had standing to bring its claims. It also expressly did not reach (or evaluate) the issue of whether the plaintiff pleaded its fraud claims with sufficient particularity.

The circuit court, however, concluded that the plaintiff's federal securities fraud claims were barred by the one-year statute of limitations applicable to such claims because the plaintiff's complaint contained an allegation indicating that it was on inquiry notice of one aspect of the alleged fraud. The circuit court relied upon an allegation in the Amended Complaint indicating that approximately fifteen months before the complaint was filed, the plaintiff became aware that the defendants may have paid a commission (the "Chesden commission") that was inconsistent with their representations to the plaintiff concerning the use of investment capital. That allegation, however, related to that subject only and not to any of the several other subjects of misrepresentations and omissions upon which the plaintiff's securities fraud claims were based.

The circuit court also affirmed the dismissal with prejudice of all of the plaintiff's claims. However, the circuit court's opinion failed to explain the grounds upon which the plaintiff's Indiana state law securities fraud claims could be dismissed, much less dismissed with prejudice. After all, unlike their federal law counterparts, there is a three-year limitations period applicable to the plaintiff's Indiana state law securities claims. IND. CODE § 23-2-1-19(g) (1998). The plaintiff's complaint indisputably was filed well within that time period, no matter how the commencement of that period is triggered (by actual or inquiry notice). The circuit court rejected the district court's conclusion on subject matter jurisdiction, and expressly did not reach or consider the issues of standing and pleading with sufficient particularity. Thus, the circuit court's opinion provides no basis for its decision on the plaintiff's Indiana state law securities claims.

The circuit court later denied the plaintiff's motion for reconsideration. It also denied the plaintiff's motion to recall the mandate and for clarification concerning its decision to affirm the dismissal of the plaintiff's Indiana state law securities fraud claims with prejudice.

D. The Basis for the District Court's Jurisdiction in this Case.

The district court had jurisdiction in this case pursuant to 28 U.S.C. §§ 1331 (federal question) and 1332 (diversity of citizenship).

REASONS FOR GRANTING THE PETITION

The circuit courts are rendering decisions in open contravention of this Court's pronouncements in *Lampf,*

Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350 (1991). Since this Court adopted the "actual notice" limitations trigger of Section 9(e) of the Securities Exchange Act of 1934 ("1934 Act") (15 U.S.C. § 78i(e)) in 1991, the circuit courts have refused to apply the actual notice standard, opting instead for an "inquiry notice" standard not found in Section 9(e). In addition, the manner in which the circuit courts have applied the inquiry notice trigger has varied greatly among, and even within, the circuits. This lack of uniformity recently was highlighted by the Tenth Circuit in *Sterlin v. Biomune Systems*, 154 F.3d 1191 (10th Cir. 1998). Clarity is needed for this important issue affecting the basic rights of victims of securities fraud.

I.

THE PETITION SHOULD BE GRANTED BECAUSE THE UNITED STATES COURTS OF APPEALS ARE REFUSING TO FOLLOW THIS COURT'S DECISION IN *LAMPF, PLEVA, LIPKIND, PRUPIS & PETIGROW V. GILBERTSON* BY APPLYING AN INQUIRY NOTICE STANDARD TO THE STATUTE OF LIMITATIONS FOR SECTION 10(b) AND RULE 10b-5 SECURITIES FRAUD CLAIMS.

In its 1991 decision in *Lampf*, this Court established a uniform limitations period for private securities fraud claims brought under Section 10(b) of the 1934 Act (15 U.S.C. § 78j(b)) and Securities and Exchange Commission Rule 10b-5 (17 C.F.R. § 240.10b-5 (1998)). Since these claims were implied by the courts, *see Superintendent of Ins. of State of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971), and not expressly created by Congress, the statutory sections on which they are based do not

provide a statute of limitations. Therefore, to establish a limitations period for these claims, this Court looked to the claims' statute of origin and its comparable remedial provisions to identify the appropriate statute of limitations. *Lampf*, 501 U.S. at 359-61.

This Court found that the 1934 Act had three limitations periods for express causes of action. *Id.* at 359-60. These limitations periods are contained in Sections 9(e), 16(b), and 18(c) of the 1934 Act. 15 U.S.C. §§ 78i(e), 78p(b), and 78r(c), respectively. This Court found Sections 9(e) and 18(c) of the 1934 Act to be the most comparable to a Section 10(b) claim since they "target the precise dangers that are the focus of § 10(b)." *Lampf*, 501 U.S. at 360.

Section 9(e) provides in pertinent part:

> No action shall be maintained to enforce any liability created under this section, unless brought within *one year after the discovery of the facts constituting the violation* and within three years after such violation.

15 U.S.C. § 78i(e) (emphasis added). Section 18(c) is very similar in language and effect. It provides:

> No action shall be maintained to enforce any liability created under this section unless brought within *one year after the discovery of the facts constituting the cause of action* and within three years after such cause of action accrued.

15 U.S.C. § 78r(c) (emphasis added). Both of these sections establish an "actual notice" standard by providing that the date on which the one-year limitations period begins to run is the date on which the victim becomes aware that he or she is in fact a victim of fraud.

This Court also considered Section 13 of the Securities Act of 1933 ("1933 Act") in its search for the appropriate limitations period. *Lampf*, 501 U.S. at 360 n.7; *see* 15 U.S.C. § 77m. Unlike Sections 9(e) and 18(c) of the 1934 Act, Section 13 of the 1933 Act sets out an "inquiry notice" standard by providing that the date on which the one-year limitations period begins to run is the date on which the victim becomes aware of facts that would lead a reasonable person to investigate whether he or she might have a claim. Section 13 provides:

> No action shall be maintained to enforce any liability created under Section 77k or 771(2) of this title unless brought within *one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence*, or, if the action is to enforce a liability created under Section 771(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under Section 77k or 771(1) of this title more than three years after the security was bona fide offered to the public, or under Section 771(2) of this title more than three years after the sale.

15 U.S.C. § 77m (emphasis added).

This Court then selected the limitations period found in Section 9(e) for Section 10(b) and Rule 10b-5 claims. *Lampf*, 501 U.S. at 364 n.9. This Court explained:

> [T]he various 1- and 3-year periods contained in the 1934 and 1933 Acts differ slightly in terminology. To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e).

Id. The Court further stated, "The 1-year period, by its terms, begins after discovery of the facts constituting the violation . . . ." *Id.* at 363.

In choosing the limitations period set forth in Section 9(e) of the 1934 Act over Section 13 of the 1933 Act, the Court adopted an "actual notice" standard for determining the commencement of the one-year limitations period in Section 10(b) and Rule 10b-5 claims. The Court concluded,

> Litigation instituted pursuant to § 10(b) and Rule 10b-5 therefore must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation.

Id. at 364.

Immediately after *Lampf* was decided, district courts in Illinois, California, New York, and Massachusetts all applied the actual notice standard of Section 9(e). *See, e.g.*,

Douglas v. Tonigan, 830 F. Supp. 457 (N.D. Ill. 1993); *In re Digital Microwave Corp. Securities Litig.*, No. C-90-20241-RMW(EAI), 1992 U.S. Dist. LEXIS 18469 (N.D. Cal. Oct. 19, 1992); *Werner v. Satterlee, Stephens, Burke & Burke*, 797 F. Supp. 1196 (S.D.N.Y. 1992); *Slavin v. Morgan Stanley & Co., Inc.*, 791 F. Supp. 327 (D. Mass. 1992); *Hauman v. Illinois Power Co.*, No. 89-1130, 1991 U.S. Dist. LEXIS 20165 (C.D. Ill. Aug. 29, 1991). However, despite this Court's unequivocal adoption of this standard, most circuit courts have refused to apply this Court's standard. Each of the following circuits apply an inquiry notice standard to Section 10(b) and Rule 10b-5 claims with varying degrees of severity:

Second Circuit: *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346 (2d Cir. 1993), *cert. denied*, 511 U.S. 1019 (1994); *Menowitz v. Brown*, 991 F.2d 36 (2d Cir. 1993).

Fourth Circuit: *Brumbaugh v. Princeton Partners*, 985 F.2d 157 (4th Cir. 1993); *Howard v. Haddad*, 962 F.2d 328 (4th Cir. 1992).

Fifth Circuit: *Topalian v. Ehrman*, 954 F.2d 1125 (5th Cir. 1992), *cert. denied*, 506 U.S. 825 (1992).

Seventh Circuit: *Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605 (7th Cir. 1995); *LaSalle v. Medco Research, Inc.*, 54 F.3d 443 (7th Cir. 1995); *Tregenza v. Great American Communications Co.*, 12 F.3d 717 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994).

Eighth Circuit: *Great Rivers Coop. of Southeastern Iowa v. Farmland Indus., Inc.*, 120 F.3d 893 (8th Cir. 1997).

Tenth Circuit: *Anixter v. Home-Stake Prod. Co.*, 939 F.2d 1420 (10th Cir. 1991), *as amended on denial of rehearing*, 947 F.2d 897 (10th Cir. 1991), *vacated on other grounds sub nom. Dennler v. Trippet*, 503 U.S. 978 (1992).

These circuits do not even apply the inquiry notice standard in a uniform fashion. The Tenth Circuit recently discussed these inconsistencies at length in *Sterlin v. Biomune Sys.*, 154 F.3d 1191 (10th Cir. 1998), and observed that the inconsistencies exist not only among the circuits, but within the circuits. *Sterlin*, 154 F.3d at 1199-1202.

The Seventh Circuit's application of the inquiry notice standard is the most draconian. The Seventh Circuit requires a victim of securities fraud to file a lawsuit within one year of becoming aware of facts that would lead a reasonable person to investigate whether he or she might have a claim, thereby creating a duty of investigation not found in Section 9(e) or in this Court's *Lampf* decision. *Tregenza*, 12 F.3d at 718, 721-22 (conceding that the Seventh Circuit's decision was an exercise of "judicial creativity").

This varied application of the inquiry notice standard encourages forum shopping and an atmosphere of uncertainty in securities litigation. The actual notice standard is much easier to apply, leads to more just results, and was adopted by this Court.

This Court stated in *Wilson v. Garcia*, 471 U.S. 261 (1985), "'Few areas of the law stand in greater need of firmly defined, easily applied rules than does the subject of periods of limitations.'" *Id.* at 266 (quoting *Chardon v. Fumero Soto*, 462 U.S. 650, 667 (1983) (Rehnquist, J.,

dissenting)); *see also Lampf*, 501 U.S. at 378 (Kennedy, J., dissenting) ("It may sometimes be easier to determine when a fraud occurred than when it should have been discovered."). The actual notice standard conforms to the policy stated in *Wilson*. It is clearly defined and not subject to varied application.

Moreover, as Justice Kennedy explained in *Lampf*, "The real burden on most investors . . . is the initial matter of discovering whether a violation of the securities laws occurred at all." *Lampf*, 501 U.S. at 377 (Kennedy, J., dissenting). Yet, under the circuits' current varied approach, a securities investor must be ever watchful of the slightest irregularity in the performance of his or her investment. Then, he or she must investigate whether he or she has a claim any time an irregularity occurs and must, within one year, uncover all of the actionable misconduct and file a complaint that can sustain an attack under Rule 9(b) of the Federal Rules of Civil Procedure. *See* Roy M. Van Cleave, *The Federal Securities Acts' One-Year Inquiry Notice Statute of Limitations: Are the Scales Tipped Against Fraud Claimants?*, 22 J. CORP. L. 79, 91-92 (1996) (discussing the "Catch-22" victims face when having to file a complaint within one year of the transaction while still complying with Rule 9(b)).

Application of the inquiry notice standard to the limitations period for private securities fraud cases, therefore, imposes what is effectively a one-year statute of repose contrary to the three-year repose period found in Section 9(e). That cannot be the result that this Court intended when it decided *Lampf*.

Between an inquiry notice trigger and the particularized pleading requirements of Rule 9(b), in

addition to the potential Rule 11 sanctions for filing a frivolous claim, victims of securities fraud are put on a collision course in their race to the courthouse. If an inquiry notice standard is applied, the brief one-year limitations period may expire well before a diligent victim even has actual knowledge of whether he or she has been a victim of fraud. The inquiry notice standard, a standard that is contrary to the limitations period adopted by this Court, thus provides shelter for the wrongdoer at the expense of the victim's right of redress for what may be a serious wrong that has caused substantial harm.

II.

THE PETITION SHOULD BE GRANTED BECAUSE THE PLAINTIFF'S FEDERAL SECURITIES FRAUD CLAIMS SHOULD NOT HAVE BEEN DISMISSED WITH PREJUDICE EVEN IF ONE ASPECT OF THOSE CLAIMS IS BARRED BY THE STATUTE OF LIMITATIONS.

The circuit court in this case affirmed the dismissal with prejudice of the plaintiff's federal securities fraud claims because it determined that the plaintiff was on inquiry notice more than a year prior to filing suit that one of the representations upon which its claims were based may have been untrue. The circuit court concurred with the district court's conclusion that the plaintiff should have conducted an investigation into all of the aspects of the defendants' fraud upon learning that one of the defendants' representations may not have been true.[1]

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[1] The plaintiff has argued below that it was not on inquiry notice of the falsity of any representation upon which its claims are based, including facts pertaining to the Chesden commission. The plaintiff merely concedes the lower courts' conclusions concerning inquiry notice of the

The problem with the lower courts' analyses is that the plaintiff's claims were predicated on misrepresentations and omissions on a variety of separate and distinct subjects. Even if the plaintiff had learned that the defendants may not have been truthful or forthcoming about one subject, this would not necessarily warrant an investigation by the plaintiff into other subject areas. It also should not preclude the plaintiff from pursuing fraud claims based upon material misrepresentations and omissions on other subjects. In addition, the lower courts should not have resolved this complex inquiry notice issue at the pleadings stage and have dismissed the plaintiff's claims with prejudice, thus denying the plaintiff the opportunity to state viable federal securities fraud claims that would not be barred by the statute of limitations.

Indeed, the Seventh Circuit itself has held that "[a] complaint should not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts in support of her claim that would entitle her to relief." *Wilczynski v. Lumbermens Mut. Cas. Co.*, 93 F.3d 397, 401 (7th Cir. 1996). Here, the plaintiff could have stated federal securities fraud claims predicated upon material misrepresentations and omissions relating to the Rimsat/Tongasat contract, the Rimsat/Russian Entities contract, the status of the GSOs, the prospectus circulated by the defendants, the undisclosed inter-relationship

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Chesden commission for purposes of this Petition only. Indeed, the record does not even establish that such a commission actually was paid. This case was dismissed at the pleadings stage before discovery on that issue could even be taken. If this Petition is granted, the plaintiff intends to establish that the courts below erred in concluding that the plaintiff was on notice of the falsity of any aspect of the defendants' fraud more than a year prior to the time that it filed suit.

between Rimsat/Tongasat and their principals, or Rimsat's general business plan, organization and set-up. However, the circuit court's decision wrongly precludes the plaintiff from even attempting to do so.

This Court should grant this Petition so that it may consider whether a plaintiff's entire fraud claim should be dismissed and the plaintiff be barred from bringing an amended fraud claim where only one aspect of its fraud claim is barred by the statute of limitations. This important issue should be clarified by this Court to prevent the kind of injustice that has occurred in this case.

III.

THE PETITION SHOULD BE GRANTED BECAUSE THE CIRCUIT COURT FAILED TO PROPERLY ADDRESS THE PLAINTIFF'S INDIANA STATE LAW SECURITIES CLAIMS.

The circuit court in this case affirmed the dismissal with prejudice of all of the plaintiff's claims in this case, including the plaintiff's Indiana state law securities fraud claims. However, the circuit court expressly rejected one of the grounds upon which the district court's dismissal of those claims was premised, and it expressly did not reach the other grounds upon which the district court's dismissal was based.

The circuit court rejected the district court's conclusion that it lacked subject matter jurisdiction in the case. The circuit court then expressly avoided consideration of the district court's summary judgment decision that the plaintiff did not have standing to bring its claims. And it expressly did not reach the only other basis upon which the

district court dismissed the plaintiff's securities fraud claims, failure to plead those claims with the requisite specificity. The statute of limitations ground upon which the circuit court affirmed the dismissal of the plaintiff's federal securities fraud claims is not applicable to the plaintiff's Indiana state law securities fraud claims because the state law claims are subject to a three year statute of limitations, (IND. CODE § 23-2-1-19(g) (1998)), as opposed to the one-year period applicable to the federal securities claims. 15 U.S.C. § 78i(e). Therefore, the circuit court did not even consider or reach any issue upon which it could have affirmed the dismissal of the plaintiff's Indiana state law securities fraud claims.

This Court has the authority to remand this case for further proceedings so that the viability of the plaintiff's Indiana state law securities fraud claims may properly be considered. By statute, "The Supreme Court . . . may remand the cause and . . . require such further proceedings to be had as may be just under the circumstances." 28 U.S.C. § 2106 (1998).

This Court historically has granted petitions for a writ of certiorari and remanded cases for consideration of issues that were vital to the proper disposition of justice in the case but that were not considered or reached by courts below. In *Guaranty Trust Co. of N.Y. v. United States*, 304 U.S. 126 (1938), this Court remanded the case to the circuit court for further proceedings on the issue of whether there was sufficient evidence in that case to warrant the dismissal of the complaint after concluding that the circuit court had not passed upon that issue. Similarly, in *United States v. Ballard*, 322 U.S. 78 (1944), this Court remanded the case to the circuit court for consideration of grounds that the respondents had claimed would justify reversing the subject

conviction entered in the case because those grounds had not been considered by the circuit court. Likewise, in *Panama Mail S.S. Co. v. Vargas*, 281 U.S. 670 (1930), this Court remanded the case to the district court to make findings of fact that it had not made that were crucial to the disposition of the case. And in *Blackburn v. Alabama*, 354 U.S. 393 (1957), this Court remanded the case for further proceedings because the record left this Court uncertain as to whether the petitioner's Fourteenth Amendment due process claim had been passed upon by the Alabama Court of Appeals.

In all of the foregoing cases, this Court recognized the need for consideration of issues that were not considered or reached by a court below that were critical to evaluating whether the right disposition was reached in the case. Here, the circuit court failed to explain the basis for its decision to affirm the dismissal of the plaintiff's Indiana state law securities fraud claims. And there is nothing in the record to support its decision. The circuit court rejected one of the grounds upon which the district court relied in dismissing those claims, and expressly did not reach the other grounds, grounds that the plaintiff strongly has contested—failure to plead the underlying fraud with sufficient particularity and standing.

Accordingly, this Court should grant this Petition and remand this case for further consideration by the circuit court of the viability of the plaintiff's Indiana state law securities fraud claims. If the circuit court concludes, as plaintiff believes it should, that the underlying fraud has been alleged with sufficient particularity and that the plaintiff has standing to bring its claims as the purchaser of the securities, the plaintiff has stated viable state law securities fraud claims. Indeed, even if the circuit court

determines that the fraud has not been alleged with sufficient particularity, the plaintiff should be given another opportunity to do so. In any event, its claims should not be dismissed with prejudice. That is why it is critical to the proper administration of justice that this Court grant this Petition and remand this case to the circuit court for further proceedings.

CONCLUSION

This Court should grant this Petition for the purpose of disavowing the practice of applying an inquiry notice standard to the statute of limitations period set forth in Section 9(e) of the Securities Exchange Act of 1934 and adopted by this Court in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson* to apply to private civil actions brought under Section 10(b) and Rule 10b-5. Such a holding would require the reversal of the decision of the Seventh Circuit because the investor in this case filed this case within one year of being on actual notice of the respondents' fraud. This Court also should grant this Petition for the purpose of evaluating whether notice of one aspect of a fraud claim triggers the running of the limitations period for a claim based upon unrelated misrepresentations and omissions. Finally, this Court should grant this Petition so that it may remand this case for proper consideration by the circuit court of the plaintiff's Indiana state law securities fraud claims.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DECIDED JULY 14, 1998

KAUTHAR SDN BHD, a Malaysian Corporation,
Plaintiff-Appellant,

v.

MICHAEL A. STERNBERG, an individual and citizen of the State of Illinois, JAMES A. SIMON, an individual and citizen of the State of Indiana, CARL B. HILLIARD, JR., et al., Defendants-Appellees.

No. 97-2795

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Appeal from the United States District Court
for the Northern District of Indiana, Fort Wayne Division.

No. 95 C 199 — William C. Lee, Chief Judge.

January 13, 1998, Argued
July 14, 1998, Decided

* * *

Before CUMMINGS, RIPPLE and ROVNER, Circuit Judges.

RIPPLE, Circuit Judge.

Kauthar SDN BHD, a Malaysian corporation, filed suit on March 10, 1995, in the United States District Court for the

Northern District of Illinois, Eastern Division, against numerous defendants. It alleged federal securities law violations, violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1962(a)-(d), and various state law claims. The case was transferred, over Kauthar's objection, to the United States District Court for the Northern District of Indiana, Fort Wayne Division. Kauthar then filed its First Amended Complaint (the "complaint"). The defendants subsequently moved to dismiss the complaint and for summary judgment. On April 14, 1997, the district court rendered its decision in three related orders dismissing the complaint and all of its claims on multiple grounds and also granting the defendants' motion for summary judgment. Kauthar now appeals. For the reasons stated in the following opinion, we affirm the judgment of the district court.

I

BACKGROUND

A. Facts[1]

This case centers on a $38 million investment made by Kauthar in a company called Rimsat, Ltd. Kauthar is a Malaysian corporation with its principal place of business in Kuala Lumpur, Malaysia. Rimsat, whose principal place of business is in Fort Wayne, Indiana, was incorporated in the Caribbean island nation of Nevis for the purpose of providing

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1. This case comes to us on appeal from the dismissal of the complaint. Consequently, we take the facts as alleged in the complaint as true for purposes of our review. See Doherty v. City of Chicago, 75 F.3d 318, 320 (7th Cir. 1996).

satellite communications services to customers within the Pacific Rim region. These satellite communications were to be provided using satellites that Rimsat had contracted to purchase from a Russian satellite company. The satellites were to be placed in geosynchronous (or geostationary) orbit positions ("GSOs") that were leased to Rimsat by a company called Friendly Islands Satellite Communications, Ltd., doing business as "Tongasat." Tongasat is incorporated in the Pacific Rim Kingdom of Tonga.

Apparently, there is a limited number of GSOs available in the world because satellites may not be put in too close proximity to one another or else communications interference occurs. Satellites in geosynchronous orbit, by definition, stay essentially in the same spot over the earth and on the same equatorial plane. Consequently, the number of these spots in space is finite and, as with all scarce resources for which there is demand, they are valuable. The International Telecommunications Union ("ITU") and the International Frequency Registration Board, agencies of the United Nations, coordinate the registration and regulation of GSO positions. Only sovereign nations may apply to the ITU for rights to a GSO position for operation of a satellite. In this case, the Kingdom of Tonga obtained seven GSOs which it leased out to others through its company Tongasat. Rimsat's apparent plan was to make its fortune by buying relatively inexpensive Russian communications satellites, leasing GSOs from Tongasat and selling satellite communications services.

Not surprisingly, such a venture is highly capital-intensive. Rimsat and various of the individual defendants involved in forming Rimsat and Tongasat sought investors for this project. Kauthar allegedly was convinced, on the basis of various

communications and meetings, that Rimsat was a worthy investment, and it sank $38 million into the venture through a purchase of Rimsat stock. Kauthar effected this purchase by wiring funds to Rimsat's bank in Fort Wayne, Indiana.

In January 1995, several of Rimsat's creditors forced Rimsat into bankruptcy by filing a petition for involuntary bankruptcy in the United States Bankruptcy Court for the Northern District of Indiana. Six weeks later, when Kauthar realized that its equity stake in Rimsat was worthless, it brought this suit. Essentially, Kauthar alleged in its complaint that all of the parties involved in soliciting its investment in Rimsat intentionally misled Kauthar about the investment. Kauthar specifically points to a document that it terms a "prospectus" that was disseminated by Rimsat to outline the company's investment and business plans. In its 113-page amended complaint, Kauthar identifies alleged misrepresentations contained in the prospectus in addition to other misrepresentations and omissions it alleges were made in the course of dealings.

B. Holding of the District Court

Rendering its decision in three related orders, the district court determined that Kauthar's complaint failed to state any tenable federal claim.

In its first two orders, the district court addressed, and dismissed, the federal causes of action. In its first order, the court addressed Kauthar's alleged federal securities fraud claims. The court held that: (1) it lacked subject matter jurisdiction to adjudicate Kauthar's federal securities claims, (2) certain of the securities claims were barred by the one-year

statute of limitations, and (3) the securities claims were not pleaded with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure.

In its second order, the district court revisited certain of the securities claims alleged in the complaint. The court held that Kauthar's claim brought under § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q, failed because there is no private right of action recognized in this circuit under that section. The court dismissed the claims under § 12(2) of the 1933 Act, 15 U.S.C. § 77l, because that section does not apply to private sales of stock and Kauthar had failed to allege sufficient facts to indicate that the transaction involved was not a private placement. The court also held that, to the extent the complaint could be construed to allege control person liability for certain of the defendants, see 15 U.S.C. § 78t(a), those claims failed because Kauthar failed to allege essential components of the claims and because the claims were not alleged with sufficient particularity.

The other set of claims addressed in the court's second order was Kauthar's allegations concerning civil RICO violations. The court dismissed all of the RICO claims on the grounds that Kauthar failed to allege satisfactorily the requisite predicate acts, failed to allege a pattern of racketeering activity and failed to allege other essential elements of individual RICO claims under 18 U.S.C. § 1962(a)-(d).

In its third order, the court granted the defendants' motion for summary judgment on the ground that Kauthar lacked standing to sue in this case because the actual purchaser of the securities was a Mr. Tajudin Bin Ramli — not Kauthar. Following the issuance of these orders, Kauthar requested a

Rule 54(b) certification in order to bring this appeal.[2] The certification was provided by the district court; this appeal followed.

II

DISCUSSION

We first shall address the issues with respect to the federal securities fraud claims and then shall turn to the civil RICO claims.

A. Securities Fraud Claims

Kauthar alleged in Counts I and II of its complaint violations of § 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, which relate to fraud in the purchase or sale of a security.[3] In Counts III and IV of its complaint, Kauthar alleged additional securities fraud claims

2. Still pending in the district court at the time appeal was taken were various cross-claims filed by Matt C. Nilson and Carl B. Hilliard against the plaintiff and certain individual defendants. The district court entered a final judgment pursuant to Rule 54(b) of the Federal Rules of Civil Procedure.

3. In addition to the § 10(b) violations, Kauthar's Counts I and II reference violations of § 20(a) of the 1934 Act. Specifically, Kauthar's complaint alleges in Counts I and II "Federal Securities Fraud in Violation of Sections 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b) 78(s)." This is puzzling as § 78(s) deals with "Registration, responsibilities, and oversight of self-regulatory organizations," none of which is at issue here. We think that Kauthar means to allege control person liability under § 20(a) of the 1934 Act, as codified at 15 U.S.C. § 78t(a). To the extent that the complaint so alleges, Kauthar's claims for control person liability were dismissed by the district court and we address that decision below.

predicated on violations of § 17(a) of the 1933 Act, 15 U.S.C. § 77q, and of § 12(2) of the 1933 Act, 15 U.S.C. § 77l. Before we address the specifics of each claim, we first consider a problem common to all of them.[4]

1. Extraterritorial Application of the Antifraud Securities Statutes

The district court determined that the securities violations alleged by Kauthar in Counts I-IV of its complaint were beyond

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4. Although there are substantial statutory standing questions raised in this appeal, we are satisfied that Kauthar's allegations meet the minimal Article III requirements of a case or controversy — concrete injury in fact, which is fairly traceable to the actions of the defendants and which is likely to be redressed by a favorable decision of the court. See Steel Co. v. Citizens for a Better Env't, 140 L. Ed. 2d 210, 118 S. Ct. 1003, 1016-17 (1998) ("This triad of injury in fact, causation, and redressability comprises the core of Article III's case-or-controversy requirement, and the party invoking federal jurisdiction bears the burden of establishing its existence." (footnote omitted)). Kauthar's allegations, taken as true in this context, state (1) that the company was injured in that it lost its $38 million investment in Rimsat, (2) that this injury was caused by virtue of Kauthar's reliance on the fraudulent misrepresentations and omissions of the defendants, and (3) that the district court could have awarded damages that would serve to redress that injury. Because Kauthar has alleged the minimum requirements for Article III standing, this case does not run afoul of the concerns raised in the Supreme Court's recent decision in Steel Company. In that case, the Court held that a court may not pass over an Article III standing question in order to reach instead a "more readily resolved" merits question. 118 S. Ct. at 1012. Because we are satisfied here that the constitutional minimum of standing is met, we have jurisdiction to address the remaining standing and merits issues. See also McNamara v. City of Chicago, 138 F.3d 1219, 1222 (7th Cir. 1998) (finding that because Article III standing was present it could bypass a prudential standing question to reach the merits of the case).

the ambit of statutory protection because they involved transnational securities transactions without a sufficient connection to the United States. Specifically, the district court held that Kauthar's allegations satisfied neither the "effects" nor the "conduct" analyses employed by federal courts to decide whether the securities acts cover a particular transnational securities transaction. We review this question of law de novo.

Courts have struggled for many years to define with meaningful precision the extent to which the antifraud provisions of the securities laws apply to securities transactions that are predominantly extraterritorial in nature but have some connection to the United States. The courts that have addressed the issue have noted that the question is a difficult one because Congress has given little meaningful guidance on the issue.[5] In addition, resort to the legislative history of the securities acts does little to illuminate Congress' intent in this area. See, e.g.,

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5. See, e.g., Robinson v. TCI/US West Communications, Inc., 117 F.3d 900, 904-05 (5th Cir. 1997) ("[W]ith one small exception the Exchange Act does nothing to address the circumstances under which American courts have subject matter jurisdiction to hear suits involving foreign transactions."); Itoba Ltd. v. Lep Group PLC, 54 F.3d 118, 121 (2d Cir. 1995) ("It is well recognized that the Securities Exchange Act is silent as to its extraterritorial application."), cert. denied, 516 U.S. 1044 (1996); Zoelsch v. Arthur Andersen Co., 262 U.S. App. D.C. 300 824 F.2d 27, 30 (D.C. Cir. 1987) (stating that provisions of 1934 Act furnish "no specific indications of when American federal courts have jurisdiction over securities law claims arising from extraterritorial transactions"). But see SEC v. Kasser, 548 F.2d 109, 114 (3d Cir.) ("[T]he anti-fraud laws suggest that such [extraterritorial] application is proper. The securities acts expressly apply to 'foreign commerce,' thereby evincing a Congressional intent for a broad jurisdictional scope for the 1933 and 1934 Acts." (citing the preambles to the Acts)), cert. denied, 431 U.S. 938 (1977).

Zoelsch v. Arthur Andersen Co., 262 U.S. App. D.C. 300, 824 F.2d 27, 30 (D.C. Cir. 1987) ("If the text of the 1934 Act is relatively barren, even more so is the legislative history. Fifty years ago, Congress did not consider how far American courts should have jurisdiction to decide cases involving predominantly foreign securities transactions with some link to the United States. The web of international connections in the securities market was then not nearly as extensive or complex as it has become."). In fact, some courts have admitted candidly that, in fashioning an approach to the issue of extraterritorial application of the securities laws, policy considerations and the courts' best judgment have been utilized to determine the reach of the federal securities laws.[6]

In dealing with this difficult area we begin, as we always do in matters of statutory interpretation, with the words of the statute. Although the statutory language gives us little guidance, it does give us some clue of the direction we must take. Congress did leave some indication in the language of the securities laws

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6. See Robinson, 117 F.3d at 905 (describing the court's task of determining jurisdiction as " 'filling the void' created by a combination of congressional silence and the growth of international commerce since the Exchange Act was passed"); Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 416 (8th Cir. 1979) (recognizing that its decision "in favor of finding subject matter jurisdiction is largely based upon policy considerations"); Kasser, 548 F.2d at 116 (stating that "it should be recognized that this case in a large measure calls for a policy decision"); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir.) ("The Congress that passed these extraordinary pieces of legislation in the midst of the depression could hardly have been expected to foresee the development of offshore funds thirty years later. . . . Our conclusions rest on . . . our best judgment as to what Congress would have wished if these problems had occurred to it."), cert. denied, 423 U.S. 1018 (1975).

about their intended application to foreign commerce. Section 10(b) prohibits fraud by the "use of any means or instrumentality of interstate commerce or of the mails" in "connection with the purchase or sale of any security." 15 U.S.C. & 78j (b). "Interstate commerce" is defined to include "trade, commerce, transportation, or communication . . . between any foreign country and any State." 15 U.S.C. § 78c(a)(17). A single passage in the statute addresses foreign transactions explicitly. As the District of Columbia Circuit noted in Zoelsch, 824 F.2d at 30, § 30(b) states that the 1934 Act "shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter." 15 U.S.C. § 78dd(b). The Supreme Court has said that "[i]t is a longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.' " EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248, 113 L. Ed. 2d 274, 111 S. Ct. 1227 (1991) (quoting Foley Bros., Inc. v. Filardo, 336 U.S. 281, 285, 93 L. Ed. 680, 69 S. Ct. 575 (1949)). But, as some courts have noted,[7] this statutory language suggests that the antifraud provisions were intended to apply to some transnational securities transactions.

Although the circuits that have confronted the matter seem to agree that there are some transnational situations to which the antifraud provisions of the securities laws are applicable, agreement appears to end at that point. Identification of those circumstances that warrant such regulation has produced a

7. See Continental Grain, 592 F.2d at 416 & n.9; Kasser, 548 F.2d at 114& n.21.

disparity in approach, to some degree doctrinal and to some degree attitudinal, as the courts have striven to implement, in Judge Friendly's words, "what Congress would have wished if these problems had occurred to it." Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir.), cert. denied, 423 U.S. 1018 (1975).

These efforts have produced two basic approaches to determining whether the transaction in question ought to be subject to American securities fraud regulation. These two approaches (we think that "test" is too inflexible a term to characterize the present state of the case law) focus on whether the activity in question has had a sufficient impact on or relation to the United States, its markets or its citizens to justify American regulation of the situation. Specifically, one approach focuses on the domestic conduct in question, and the other focuses on the domestic effects resulting from the transaction at issue.[8]

When focusing on the effects, the courts seek to determine whether actions " 'occurring in foreign countries

8. The general approach of the courts has been to assume that the securities laws are applicable if either approach so indicates. See Robinson, 117 F.3d at 905; Zoelsch, 824 F.2d at 30; Tamari v. Bache Co. (Lebanon) S.A.L., 547 F. Supp. 309, 311 (N.D. Ill. 1982). We note, however, that the Second Circuit, from which these analytical approaches of conduct and effects originated, has recently stated that they need not "be applied separately and distinctly from each other" and that, in fact, "an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court." Itoba Ltd., 54 F.3d at 122. Since the aim of this inquiry is to measure the degree of United States involvement in the transaction in question, the joint assessment of conduct and effects seems appropriate because it permits a more comprehensive assessment of the overall transactional situation.

have caused foreseeable and substantial harm to interests in the United States.' " Mak v. Wocom Commodities Ltd., 112 F.3d 287, 289 (7th Cir. 1997) (quoting Tamari v. Bache Co. (Lebanon) S.A.L., 730 F.2d 1103, 1108 (7th Cir.), cert. denied, 469 U.S. 871, 83 L. Ed. 2d 151, 105 S. Ct. 221 (1984)). Several cases have examined the type and severity of the harm that must be suffered domestically in order to enable an exercise of jurisdiction.[9] This case, however, affords us no occasion to explore this approach; the record does not reveal sufficient effect on domestic interests to justify its invocation here.

In contrast with the effects analysis, which examines actions occurring outside of the United States, the conduct analysis focuses on actions occurring in this country as they "relate[ ] to the alleged scheme to defraud." Tamari, 730 F.2d at 1107. The chronic difficulty with such a methodology has been describing, in sufficiently precise terms, the sort of conduct occurring in the United States that ought to be adequate to trigger American regulation of the transaction. Indeed, the circuits that have confronted the matter have articulated a number of methodologies.

The predominant difference among the circuits, it appears, is the degree to which the American-based conduct must be related causally to the fraud and the resultant harm to justify the application of American securities law. At one end of the spectrum, the District of Columbia Circuit appears to require that the domestic conduct at issue must itself constitute a securities violation. See Zoelsch, 824 F.2d at 31 ("Jurisdiction will lie in American courts where the domestic conduct

9. See generally George K. Chamberlin, Annotation, Subject Matter Jurisdiction of Securities Fraud Action Based on Foreign Transactions, under Securities Exchange Act of 1934, 56 A.L.R. Fed. 288 (1982).

comprises all the elements of a defendant's conduct necessary to establish a violation of section 10(b) and Rule 10b-5.").[10] At the other end of the spectrum, the Third, Eighth and Ninth Circuits, although also focusing on whether the United States-based conduct caused the plaintiffs' loss, to use the Fifth Circuit's words, "generally require some lesser quantum of conduct." Robinson v. TCI/US West Communications, Inc., 117 F.3d 900, 906 (5th Cir. 1997). In SEC v. Kasser, 548 F.2d 109, 114 (3d Cir.), cert. denied, 431 U.S. 938 (1977), the Third Circuit stated that the conduct came within the scope of the statute if "at least some activity designed to further a fraudulent scheme occurs within this country." The Eighth Circuit, in Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 421 (8th Cir. 1979), held that the antifraud provisions we're applicable when the domestic conduct "was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment." The Ninth Circuit adopted the Continental Grain approach in Grunenthal GmbH v. Hotz, 712 F.2d 421, 425 (9th Cir. 1983).

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10. Indeed, in Zoelsch, the court expressed doubt "that an American court should ever assert jurisdiction over domestic conduct that causes loss to foreign investors." 824 F.2d at 32. In adopting this restrictive approach, the District of Columbia Circuit claimed to adopt expressly the Second Circuit's methodology. See id. at 33. We share the reservations of the Fifth Circuit as to whether the District of Columbia Circuit accurately portrayed the Second Circuit's jurisprudence. See Robinson, 117 F.3d at 905 n.10. Rather, we believe that the Fifth Circuit more accurately mirrored the Second Circuit's approach, which it articulated as: "Where (as here) the alleged fraud is in connection with a sale of securities to a foreigner outside the United States, the federal securities laws apply only if acts or culpable failures to act within the United States directly caused the plaintiff's loss." Robinson, 117 F.3d at 905.

Appendix A

Our colleagues in the Second and Fifth Circuits have set a course between the two extremes that we have just discussed. That approach requires a higher quantum of domestic conduct than do the Third, Eighth and Ninth Circuits. See Robinson, 117 F.3d 900, 905-06 (5th Cir. 1997). The Second Circuit has stated that foreign plaintiffs' suits[11] under the antifraud provisions of the securities laws, such as Kauthar's, will be "heard only when substantial acts in furtherance of the fraud were committed within the United States." Psimenos v. E.F. Hutton Co., Inc., 722 F.2d 1041, 1045 (2d Cir. 1983).[12] Furthermore, if the United States-based activities were merely preparatory in nature, or if the " 'bulk of the activity was performed in foreign countries,' " jurisdiction will not exist. Id. at 1046 (quoting IIT v. Vencap, Ltd., 519 F.2d 1001, 1018

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11. The Second Circuit had distinguished the conduct analysis' requirements with respect to the residence and citizenship of the security purchasers in its earlier decision in Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir.), cert. denied, 423 U.S. 1018 (1975).

12. In Psimenos, a case brought under the Commodity Exchange Act, the Greek plaintiff alleged fraud in the defendant's managers' handling of his commodities transactions. Although the court noted that "most of the fraudulent misrepresentations alleged in the complaint occurred outside the United States," it found the conduct analysis was satisfied because a pamphlet emanating from the defendant's New York office indicated that the managers would be supervised and because the alleged fraud was completed "by trading domestic futures contracts on American commodities exchanges." 722 F.2d at 1044, 1046. Other cases have indicated that effecting transactions on exchanges in America is sufficient conduct in the United States to satisfy the conduct test. See, e.g., Tamari, 730 F.2d at 1108 (adopting district court's analysis that wiring of orders for commodity transactions to the United States and execution of those orders on Chicago exchanges was sufficient conduct to satisfy the conduct test).

(2d Cir. 1975)). In addition, only "where conduct 'within the United States directly caused' the loss will a district court have jurisdiction over suits by foreigners who have lost money through sales abroad." Id. (quoting Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir.), cert. denied, 423 U.S. 1018 (1975)); see also Vencap, 519 F.2d at 1018.

Although this court has not had occasion to articulate an approach to the extraterritorial application of the securities laws, we have employed these concepts with respect to analogous actions brought under the Commodity Exchange Act. See Mak, 112 F.3d at 288-89; Tamari, 730 F.2d at 1107 & n.11. In that context, we have stated that "when the conduct occurring in the United States is material to the successful completion of the alleged scheme, jurisdiction is asserted based on the theory that Congress would not have intended the United States to be used as a base for effectuating the fraudulent conduct of foreign companies." Tamari, 730 F.2d at 1108. We think that our approach under the Commodities Act ought to be followed with respect to the securities laws and, although stated more generally, that it represents the same midground as that identified by the Second and Fifth Circuits. In our view, the absence of all but the most rudimentary Congressional guidance counsels that federal courts should be cautious in determining that transnational securities matters are within the ambit of our antifraud statutes. Nevertheless, we would do serious violence to the policies of these statutes if we did not recognize our Country's manifest interest in ensuring that the United States is not used as a "base of operations" from which to "defraud foreign securities purchasers or sellers." Kasser, 548 F.2d at 116. This interest is amplified by the fact that we live in an increasingly global financial community. The Second and Fifth Circuit's iterations of the test embody a satisfactory

balance of these competing considerations. This analytical pattern will enable the courts to address situations in which the United States is being used as a launching pad for fraudulent international securities schemes. At the same time, it will cause us to refrain from adjudicating disputes which have little in the way of a significant connection to the United States.

We believe, therefore, that federal courts have jurisdiction over an alleged violation of the antifraud provisions of the securities laws when the conduct occurring in the United States directly causes the plaintiff's alleged loss in that the conduct forms a substantial part of the alleged fraud and is material to its success. This conduct must be more than merely preparatory in nature; however, we do not go so far as to require that the conduct occurring domestically must itself satisfy the elements of a securities violation.

We turn now to an application of these principles to Kauthar's allegations. Kauthar argues that a host of alleged general activities undertaken by various of the defendants constitutes conduct that was part of the scheme to defraud Kauthar and to solicit Kauthar's investment in Rimsat. Kauthar alleges that various documents containing fraudulent misrepresentations and omissions were prepared in the United States and were sent to it by wire and by the United States mail in an effort to obtain Kauthar's investment. Kauthar also alleges that phone calls were made from Fort Wayne, Indiana, and from San Diego, California, for the same purpose. Kauthar further alleges that the defendants had meetings and phone conversations in the United States to discuss the deceptive information contained in the prospectus and to "ultimately agree upon a plan to obtain equity funding from Kauthar by means of false and deceptive statements of fact." R.111 ¶ 60. Thus,

according to the complaint, the United States was utilized as a base of operations from which to launch the defendants' fraudulent scheme to defraud Kauthar. Moreover, Kauthar also alleges a set of specific acts that, in combination with those already mentioned, satisfy the conduct analysis. Specifically, Kauthar alleges that it wired the payment for the Rimsat securities, over $38 million, in six installments to Rimsat's bank account in Fort Wayne, Indiana. Therefore, Kauthar has alleged that the defendants conceived and planned a scheme to defraud Kauthar in the United States, that they prepared materials in support of the scheme to solicit the payment in the United States and sent those materials from the United States via the United States mail, and that they received in the United States the fraudulently solicited payment for the securities — the final step in the alleged fraud. We think these allegations sufficient to bring the alleged conduct within the ambit of the securities laws. We are therefore constrained to disagree respectfully with the district court's contrary conclusion.

2. Waiver

Because we have determined that the court did have jurisdiction to consider the securities violations claims alleged in Counts I-IV of Kauthar's complaint (to the extent that the conduct analysis is satisfied), we must determine whether those claims survive the alternative holdings upon which the district court also based its decision to dismiss the action. Several of the securities claims have been waived on appeal because Kauthar failed to challenge various of the district court's holdings with respect to those claims. We consistently have held that a party's failure to address a claim in its opening brief results in a waiver of that issue. See Sere v. Board of Trustees of the Univ. of Ill., 852 F.2d 285, 287 (7th Cir. 1988) ("It is not

the obligation of this court to research and construct the legal arguments open to parties, especially when they are represented by counsel. . . . We consistently and evenhandedly have applied the waiver doctrine when appellants have failed to raise an issue in their opening brief." (internal quotations and citations omitted)). Moreover, in situations in which there is one or more alternative holdings on an issue, we have stated that failure to address one of the holdings results in a waiver of any claim of error with respect to the court's decision on that issue. See Williams v. Leach, 938 F.2d 769, 772 (7th Cir. 1991) (holding that Williams' failure to raise on appeal the alternative ground for dismissal of claim based on statute of limitations resulted in waiver of issue on appeal); Landstrom v. Illinois Dep't of Children Family Servs., 892 F.2d 670, 678 (7th Cir. 1990) (stating that because the plaintiffs failed to challenge expressly the district court's alternative holding with respect to Count II of the complaint, they had "waived any claim of error in that ruling").

Although Kauthar argues that it did not waive these issues on appeal because it incorporated by reference arguments on these issues made to the district court, we have made it clear that this practice is unacceptable and that it cannot serve as a valid presentation of an argument on appeal. See Prudential Ins. Co. of Am. v. Sipula, 776 F.2d 157, 161 n.1 (7th Cir. 1985) (expressing in "the strongest terms our disapproval of the practice" of incorporating by reference briefs submitted to the district court because it unnecessarily diffuses the issues on appeal and constitutes an attempt to avoid page limitations for appellate briefs; warning that future occurrences may be sanctionable). In addition, to the extent to which Kauthar tries to cure the waiver by raising new arguments in its reply brief, this practice is also inappropriate. See Estate of Phillips v. City

of Milwaukee, 123 F.3d 586, 597 (7th Cir. 1997) (stating that arguments made for the first time in a reply brief are waived), cert. denied, 118 S. Ct. 1052 (1998). In light of these waiver principles, we turn to the specific claims on appeal.

In Count III of the complaint, Kauthar alleged that various of the defendants committed securities fraud in violation of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q. However, in setting forth this claim in the complaint, Kauthar acknowledged that this court has held that no private right of action exists under § 17(a), see Schlifke v. Seafirst Corp., 866 F.2d 935, 942-43 (7th Cir. 1989), and expressly anticipated that the claim would be dismissed by the district court, and it was. Nevertheless, on appeal, this court's holding in Schlifke has not been addressed and the dismissal of Count III has not been directly challenged or argued. The only reference to the § 17(a) claims of Count III in Kauthar's brief is in a footnote that states, "Kauthar refers this Court to its underlying Memorandum . . . for a detailed discussion of these well-pleaded claims." Appellant's Br. at 25 n.17. As we have just explained, this is not an adequate presentation of an issue to this court on appeal; accordingly, the issue of whether the district court erred in dismissing Count III is waived.

A similar result obtains with respect to the allegations of securities fraud contained in Count IV. In that count, Kauthar alleged violations of § 12(2) of the 1933 Act, 15 U.S.C. § 77l; the district court dismissed the claims for failure to state a claim upon which relief could be granted. Noting that the Supreme Court held in Gustafson v. Alloyd Co., 513 U.S. 561, 131 L. Ed. 2d 1, 115 S. Ct. 1061 (1995), that § 12(2) applies only to public offerings of securities and not to private placements, the district court examined the allegations to

ascertain whether Kauthar had alleged sufficiently that it had purchased the securities pursuant to a public offering. The district court was not persuaded that Kauthar had purchased the Rimsat stock pursuant to a public offering because, among other reasons, the document that Kauthar termed a "prospectus" expressly stated that the material it contained was confidential and proprietary. The court determined that this language is inconsistent with an offering to the public and further found inadequate Kauthar's allegations on information and belief that the document was disseminated to members of the public. Once again, despite the district court's clear articulation of its basis for dismissing the § 12(2) claims, Kauthar did not challenge this ground of decision anywhere in its brief. As with the securities fraud violations alleged in Count III, Kauthar's only attempt to address this basis of decision is to refer this court in a footnote to a memorandum submitted to the district court which purportedly contains its position on the § 12(2) claims. Accordingly, the claims with respect to § 12(2) are also waived.

Finally, to the extent that Kauthar alleged control person liability in its complaint, any argument with respect to those claims also has been waived. The district court found that Counts I and IV could be construed to assert claims for control person liability under § 20 of the 1934 Act, 15 U.S.C. § 78t(a). The court reasoned that because this type of liability is derivative, a control person can be held accountable only if there is an underlying violation of the securities laws. The court found that Kauthar had not alleged any primary violation of the securities laws by Rimsat; correspondingly, it held that there could be no derivative control person liability because there was no allegation of a primary violation. Nowhere in its brief does Kauthar challenge the court's holding with respect to control person liability. Consequently, those claims are also waived.

Appendix A

3. Statute of Limitations

Despite Kauthar's waiver of various of its claims, it did challenge all of the grounds of decision to dismiss its allegations of securities fraud violations predicated on § 10(b) and Rule 10b-5 contained in Counts I and II. In addition to holding that the described transnational transaction was not within the ambit of the statute, see supra section A1, the district court dismissed the alleged violations of § 10(b) and Rule 10b-5 in Counts I and II because they were not timely filed and because they failed to state claims for fraud with the minimum level of particularity required under Rule 9(b) of the Federal Rules of Civil Procedure.[13]

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13. The court also granted summary judgment in favor of the defendants on these claims on the ground that Kauthar lacked standing to sue under § 10(b) and Rule 10b-5 because it was not the actual purchaser of the securities. The purchaser standing rule derives from the Supreme Court's decision in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730-31, 44 L. Ed. 2d 539, 95 S. Ct. 1917 (1975). However, the rule has not been followed absolutely; courts have allowed various parties that are not actually "purchasers" to assert claims under certain circumstances. See Soderberg v. Gens, 652 F. Supp. 560, 563 (N.D. Ill. 1987) (although stating rule that the federal cause of action "does not attach automatically to the security itself and pass to the next purchaser," the court notes cases in which non-purchasers were permitted to assert claims, such as shareholders' derivative claims brought on behalf of the corporation-purchaser). Consequently, the purchaser standing question appears to us to be a statutory standing issue directly analogous to the "zone of interests" doctrine, one of the "set of prudential principles that bear on the question of standing." Bennett v. Spear, 520 U.S. 154, 117 S. Ct. 1154, 1161, 137 L. Ed. 2d 281 (1997) (internal quotation omitted). Because this standing question is prudential in nature, we may "elide the jurisdictional issue" in order to reach the merits of the district court's grounds for dismissing the securities claims. See McNamara v.

(Cont'd)

We turn first to the district court's decision to dismiss the § 10(b) and Rule 10b-5 securities claims for failure to comply with the statute of limitations. We review de novo the district court's decision to dismiss, taking Kauthar's factual allegations as true and drawing all reasonable inferences in Kauthar's favor. See Whirlpool Fin. Corp. v. GN Holdings, Inc., 67 F.3d 605, 608 (7th Cir. 1995). We have noted that, because the question of whether a plaintiff had sufficient facts to place it on inquiry notice of a claim for securities fraud is one of fact, it may be "inappropriate for resolution on a motion to dismiss under Rule 12(b)(6)." Marks v. CDW Computer Centers, Inc., 122 F.3d 363, 367 (7th Cir. 1997). However, we have also stated that, if a "plaintiff pleads facts that show its suit [is] barred by a statute of limitations, it may plead itself out of court under a Rule 12(b)(6) analysis." Whirlpool, 67 F.3d at 608.[14]

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City of Chicago, 138 F.3d 1219, 1222 (7th Cir.1998) (noting that the Supreme Court in Steel Company v. Citizens for a Better Environment, __ U.S. __, __, 118 S. Ct. 1003, 1013 & n.2, 140 L.Ed.2d 210 (1998), authorized courts to reach merits questions prior to prudential standing issues).

14. Accord Tregenza v. Great Am. Communications Co., 12 F.3d 717, 718 (7th Cir. 1993) (stating that if a party "pleads facts that show that his suit is time-barred or otherwise without merit, he has pleaded himself out of court"), cert. denied, 511 U.S. 1085, 128 L. Ed. 2d 465, 114 S.Ct. 1837, 128 L.Ed.2d 465 (1994); see also LaChapelle v. Berkshire Life Ins. Co., 142 F.3d 507, 509 (1st Cir. 1998) ("Granting a motion to dismiss based on a limitations defense is entirely appropriate when the pleader's allegations leave no doubt that an asserted claim is time-barred."); Estate of Blue v. County of Los Angeles, 120 F.3d 982, 984 (9th Cir. 1997) (holding that it was not error to decide the statute of limitations question on a motion to dismiss because the pleadings contained sufficient facts to decide the matter), cert. denied, __ U.S. __,

(Cont'd)

Claims under § 10(b) of the 1934 Act must be brought within one year of the discovery of the violation. See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991). Discovery occurs when a potential plaintiff has inquiry or actual notice of a violation. See Tregenza v. Great Am. Communications Co., 12 F.3d 717 (7th Cir. 1993), cert. denied, 511 U.S. 1085, 128 L. Ed. 2d 465, 114 S. Ct. 1837 (1994). Inquiry notice is "the term used for knowledge of facts that would lead a reasonable person to begin investigating the possibility that his legal rights had been infringed." LaSalle v. Medco Research, Inc., 54 F.3d 443, 446 (7th Cir. 1995). However, more than "merely suspicious circumstances" must exist; instead, the plaintiff must learn of a circumstance that places him "in possession of, or with ready access to, the essential facts that he needs in order to be able to sue." Fujisawa Pharm. Co., Ltd. v. Kapoor, 115 F.3d 1332, 1337 (7th Cir. 1997).

The district court determined that, although Kauthar did not file the suit until March 1995, Kauthar alleged facts in its complaint indicating that it was aware in September 1993 of

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118 S. Ct. 1042, 140 L.Ed.2d 107 (1998); LRL Properties v. Portage Metro Housing Auth., 55 F.3d 1097, 1107 n.6 (6th Cir. 1995) (noting that when " 'the face of the complaint affirmatively indicates that the time limit for bringing the claim has passed, that plaintiff may [not] escape the statute by saying nothing.' " (quoting Hoover v. Langston Equip. Assocs., 958 F.2d 742, 745 (6th Cir. 1992)); Oshiver v. Levin, Fishbein, Sedran Berman, 38 F.3d 1380, 1384 n.1 (3d Cir. 1994) ("While the language of Fed. R. Civ. P. 8(c) indicates that a statute of limitations defense cannot be used in the context of a Rule 12(b)(6) motion to dismiss, an exception is made where the complaint facially shows noncompliance with the limitations period and the affirmative defense clearly appears on the face of the pleading."); Sanders v. Department of Army, 981 F.2d 990, 991 (8th Cir. 1992) (same).

facts that placed it on inquiry notice. Kauthar alleged in its complaint that some of the significant fraudulent omissions regarding its investment in Rimsat concerned a fee paid by Rimsat to Chesden, Ltd. Chesden is allegedly a Hong Kong corporation controlled by various of the defendants. Kauthar claims that it relied in part on the representation contained in the "prospectus" that of the "$25,000,000 equity, the first $8,750,000 . . . will go nearly exclusively for the construction of satellites and the lease of the orbital positions." R.111 ¶ 91(k). However, instead of this use of the funds, $3.8 million allegedly was paid to Chesden as an undisclosed "finder's fee." Id. In Kauthar's own words, the nondisclosure of this payment "was material because Kauthar was entitled to know that 10% of its $38,095,238 investment . . . was not going into securing, or funding amounts due under, the Tongasat Agreement . . . or for other legitimate business purposes; but rather, was being diverted away from Rimsat." R.111 ¶ 100(a).

Kauthar acknowledges in its complaint that it "learned of the allegation of the payment by Rimsat of the so-called Chesden finder's-fee in approximately September 1993." R.111, Count IV, ¶ 119. However, Kauthar states that Hilliard, a defendant, wrote to Kauthar stating that "he had never received any monies from the so-called Chesden finder's-fee." Id. Kauthar maintains that the district court erred in holding that its alleged awareness of the existence of this previously nondisclosed $3.8 million payment was sufficient to put Kauthar on alert that it might be a victim of fraud. In support of this argument, Kauthar asserts in its brief that "the payment of the Chesden commission is simply irrelevant," apparently on the theory that its claims "are based upon numerous misrepresentations and omissions, the most critical of which related to" other aspects of the investment with Rimsat such as

the "Rimsat/Tongasat contract . . . the status of the geostationary slots . . . [and] the Prospectus." Appellant's Br. at 19.

Although it is true that Kauthar has alleged a plethora of fraudulent misrepresentations and omissions regarding a number of different aspects of its course of business dealings with the defendants, Kauthar's allegation that Rimsat diverted 10% of its $38 million investment to an undisclosed Hong Kong corporation certainly is not "irrelevant." Kauthar alleged that the initial $8.75 million of its investment was to be used for explicit business purposes; Kauthar also alleged that $3.8 million of that money instead was diverted to Chesden and that it was aware of the possibility of this diversion in September 1993. We believe that the district court was on solid ground in concluding that this situation should have been sufficient to prompt an investigation into the matter. As part of the agreement of the investment in Rimsat, Kauthar was represented on the Board of Directors. Indeed, Kauthar had the "power to appoint one-half of the directors to the Rimsat Board." R.111 ¶ 103. Consequently, it had ready access to the financial information of the company and could have verified the existence of the Chesden fee.[15] We do not think Kauthar's obligation to inquire was satisfied even if one of the defendants told Kauthar that he had not received any of those diverted funds. In these circumstances, we agree with the district court that Kauthar has pleaded that it was aware of sufficient facts to enable it to

15. Although Kauthar's simple awareness of the existence of the Chesden commission may be enough for inquiry notice, the availability of this avenue for ready access to Rimsat's financial information satisfies the concern addressed in Marks v. CDW Computer Centers, Inc., 122 F.3d 363, 368 (7th Cir. 1997), that inquiry notice "does not begin to run unless and until the investor is able, with the exercise of reasonable diligence (whether or not actually exercised), to ascertain the information needed to file suit."

learn that it had a cause of action for fraud against the defendants more than one year before it filed suit. Accordingly, the court correctly concluded that the § 10(b) and the Rule 10b-5 violations alleged in Counts I and II of the complaint are time barred.[16]

B. RICO Claims

Kauthar alleged, in addition to its securities fraud claims and various state law violations, civil RICO claims predicated on 18 U.S.C. § 1962(a)-(d) in Counts IX-XIV of the complaint.[17] The district court dismissed all of the claims on several alternative grounds. First, the court held that the claims were deficient because they failed to plead sufficient predicate acts — a vital component of any RICO claim. Second, the court determined that Kauthar had not alleged sufficiently a pattern of racketeering activity. Finally, the court held that each individual RICO claim failed for various claim-specific reasons. As mentioned previously, we review de novo the district court's decision to dismiss for failure to state a claim.

However, before reaching the merits of any of those holdings, we note that Kauthar encounters statutory standing difficulties with respect to its RICO claims similar to those

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16. Because we affirm the district court's decision with respect to these counts on statute of limitations grounds, it is unnecessary for us to discuss whether the plaintiff's complaint complies with the specificity requirements of Rule 9 of the Federal Rules of Civil Procedure.

17. Specifically, Kauthar alleged violations of § 1962(a)-(c) in Counts IX, X, and XI, respectively. In Counts XII-XIV, Kauthar alleged that various defendants conspired to violate § 1962(a)-(c), respectively, in violation of § 1962(d).

that plagued its securities claims. In particular, there are significant questions pertaining to the extraterritorial scope of RICO. The Second Circuit recently observed that the "tests for asserting jurisdiction extraterritorially vary depending on the substantive law to be applied abroad." North South Fin. Corp. v. Al-Turki, 100 F.3d 1046, 1052 (2d Cir. 1996). The court in Al-Turki reviewed the conduct and effects analyses that have been developed in the areas of securities and antitrust law and determined that it was "not at all clear . . . that the conduct test, as it has developed in foreign securities fraud cases, governs in cases involving the extraterritorial application of RICO." Id. The court ultimately concluded that "specifying the test for the extraterritorial application of RICO is delicate work. That work has not been done, but we need not do it now." Id. Taking note of the issue, we too decide that this question more appropriately awaits another day when we are required to determine the appropriate approach for the extraterritorial application of RICO. Because this is a statutory standing question, we need not resolve it definitively before addressing merits questions. See Steel Co. v. Citizens for a Better Env't, 140 L. Ed. 2d 210, 118 S. Ct. 1003, 1013 & n.2 (1998).

Turning to the merits of the claims, we confront another situation in which Kauthar has failed to challenge certain grounds of the district court's decision with respect to its RICO claims. Although Kauthar challenged the district court's conclusions that it had failed to allege sufficient predicate acts and a pattern of racketeering, Kauthar neglected to challenge the specific findings the court made with respect to each count of the complaint.[18] Accordingly, those claims are waived.

18. Kauthar, in its reply brief, attempts to explain away this problem on the ground that it was focusing in its opening brief on the "core of (Cont'd)

Appendix A

In Count IX of the complaint, Kauthar alleged that the defendants committed civil RICO violations, in contravention of 18 U.S.C. § 1962(a). Section 1962(a) prohibits any person who receives income from a pattern of racketeering activity from using that income to acquire any interest in, or to establish or to operate any enterprise engaged in, interstate or foreign commerce. The district court determined that Kauthar failed to allege crucial elements of a § 1962(a) claim, including a failure to allege that the defendants received income from the alleged racketeering activities and that the allegations failed to demonstrate that any such funds had been invested in an enterprise (Rimsat).

Similarly, in Count X, Kauthar alleged violations of 18 U.S.C. § 1962(b), which prohibits acquiring or maintaining directly or indirectly, through a pattern of racketeering activity, any interest in an enterprise engaged in interstate or foreign commerce. The court found that this claim failed because Kauthar did not allege any facts showing that the defendants acquired or maintained an interest in Rimsat through a pattern of racketeering activity. Moreover, the court determined that Kauthar had not alleged that it had suffered any injury as a result of the alleged violations of § 1962(a) or (b).

(Cont'd)

the District Court's ruling" and that the "remaining portion of the District Court's Order merely adopted Defendants' arguments in support of their motion to dismiss the RICO claims." Reply Br. at 13. Moreover, Kauthar appears to rely on the assertion that "the sufficiency of the Complaint was well-briefed below" for the proposition that its need to address all of the bases for the district court's decision is somehow vitiated. Id. Kauthar also attempts to cure its waiver problem by challenging in its reply brief the grounds of decision that it failed to address previously. This method of proceeding is flatly contrary to our case law.

In Count XI of the complaint, Kauthar alleged violations of 18 U.S.C. § 1962(c). That RICO section prohibits any person employed by or associated with an enterprise engaged in interstate or foreign commerce from conducting or participating in the conduct of the enterprise's affairs through a pattern of racketeering activity. The court found that because the complaint failed to establish that the defendants participated in the operation or management of Rimsat, those claims were untenable.

Finally, in Counts XII-XIV, Kauthar alleged that the defendants conspired to violate 18 U.S.C. § 1962(a)-(c), respectively, in violation of 18 U.S.C. § 1962(d). Again, the court found that the complaint's allegations were deficient because the elements of a RICO conspiracy including the requisite agreement were not sufficiently set forth.

Kauthar chose not to address any of these claim-specific grounds for dismissal in its brief. Accordingly, we cannot consider them now. We recognize that the district court's multiple orders and multiple grounds of decision resulted in a challenging task for Kauthar to cover all grounds on appeal. This situation does not excuse it from addressing all of the grounds of decision. We note that no attempt to seek permission to file an oversized brief was made by Kauthar.

Appendix A

Conclusion

For these reasons, the judgment of the district court is affirmed.

AFFIRMED.

APPENDIX B — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DATED SEPTEMBER 23, 1998

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

September 23, 1998

Before

Hon. KENNETH F. RIPPLE, *Circuit Judge*

No. 97-2795

KAUTHAR SDN BHD, a Malaysian corporation,

Plaintiff-Appellant,

v.

MICHAEL A. STERNBERG, an individual and citizen of the State of Illinois, JAMES A. SIMON, an individual and citizen of the State of Indiana, CARL B. HILLIARD, JR., et al.,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Indiana, Fort Wayne Division.

No. 95 C 199

William C. Lee, Chief Judge.

Appendix B

The following is before the court:

1. APPELLANT'S MOTION TO RECALL MANDATE AND FOR CLARIFICATION, filed on August 28, 1998, by counsel for the appellant.

2. BRIEF OF APPELLEES CARL B. HILLIARD, JR. AND SHARON HILLIARD IN OPPOSITION TO APPELLANT'S MOTION TO RECALL MANDATE, filed on September 8, 1998, by counsel for appellees Carl B. Hilliard, Jr. and Sharon Hilliard,

3. OPPOSITION OF APPELLEES FRIENDLY ISLANDS SATELLITE COMMUNICATIONS, LTD., HER ROYAL HIGHNESS PRINCESS SALOTE MAFILEO PILOLEVU TUITA, MR. JERRY J. FLETCHER AND W.L. PRITCHARD & CO., INC. TO APPELLANT'S MOTION TO RECALL MANDATE AND FOR CLARIFICATION, filed on September 8, 1998, by counsel for appellees.

IT IS ORDERED that #1 is DENIED.

APPENDIX C — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF INDIANA, FORT WAYNE DIVISION FILED APRIL 14, 1997

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

CIVIL NO. 1: 95cv199

KAUTHAR SDN BHD, a Malaysian corporation,

Plaintiff,

v.

MICHAEL A. STERNBERG, et al.,

Defendants.

ORDER

On March 11, 1997, Kauthar filed a "Motion for Decision", requesting that this court render a decision on its "Motion to Lift Stay of Discovery", filed on October 24, 1996. The defendants filed an objection to the motion on March 19, 1997. In its "Motion for Decision", Kauthar recites the fact that the present action was filed on March 10, 1995, and is thus two years old. Kauthar has taken the position that the stay of discovery in this case has operated as a delay in Kauthar's "search for the truth", and has inhibited Kauthar's ability to present its case.

Appendix C

This court entered a stay of discovery on July 21, 1995, which stay was to be effective until after the pending motions to dismiss had been disposed of. Kauthar has, in fact, been permitted to conduct limited discovery on the jurisdictional issues in this case. In fact, such discovery, in part, led Kauthar to file an amended complaint on September 29, 1995. Moreover, that Kauthar has taken full advantage of this opportunity to conduct discovery is well reflected in the record in this case. The stay also permitted the parties to conduct an extensive mediation conference after the filing and briefing of the motions in an effort to resolve the case either in part or in whole. Moreover, as the orders entered in conjunction with this order will show, retaining the stay of discovery was a prudent decision by this court.

The present case involves complex securities law claims and RICO claims, as well as lesser claims, against 12 defendants. As of March 19, 1997, there were 23 motions pending in this case. These motions are accompanied by voluminous briefs and supporting exhibits, such that this case presently comprises 20 volumes, each of which is well over two inches thick.

The pending motions in this case are as follows:

1. A motion by the Tongasat defendants to dismiss the amended complaint.

2. A motion by the Hilliard defendants to dismiss the amended complaint, or in the alternative, for summary judgment.

3. A motion by the Nilson defendants to dismiss the amended complaint.

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4. A motion by Kauthar for a default judgment against the defendant, Larry Risser.

5. A motion by the Hilliard defendants to dismiss the cross-claims of defendants Simon and Sternberg.

6. A motion by the Nilson defendants to dismiss the cross-claims of defendants Simon and Sternberg.

7. A motion by Kauthar seeking reversal of an order entered by Magistrate Judge Cosbey.

8. A motion by defendants Simon and Sternberg to dismiss Counts 6 and 7 of defendant Nilson's cross-claim.

9. A motion by defendant Fletcher to dismiss the cross-claim of defendant Nilson.

10. A motion by plaintiff Kauthar to remedy misnomer.

11. A motion by plaintiff Kauthar to dismiss the Hilliard defendants' cross-claims and counter-claims.

12. A motion by plaintiff Kauthar to transfer this case.

13. A motion by Kauthar to lift the stay of discovery and for a protective order.

14. A motion by defendant Nilson for summary judgment.

15. A motion by the Hilliard defendants for summary judgment.

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16. A motion by defendant Nilson and defendant NRC for summary judgment.

17. A motion by defendants Simon and Sternberg for summary judgment.

18. A motion by the Tongasat defendants for summary judgment.

19. A motion by plaintiff Kauthar to dismiss the counter-claim of defendant Nilson.

20. A motion by defendants Simon and Sternberg for sanctions against defendant Hilliard.

21. A motion by Kauthar to reconsider an order entered by Magistrate Judge Cosbey denying Kauthar's motion for order modifying writ of attachment.

22. A motion by the Hilliard defendants to strike a belated affidavit of Tajudin bin Ramli.

23. A motion by plaintiff Kauthar for decision on motion to lift the stay of discovery.

On November 25, 1996 the parties to this case held an extensive mediation conference. Although none of the pending issues were resolved, the parties indicated to the court that the resolution of certain issues would possibly facilitate settlement of part or all of the case. The issues identified by the parties were: (1) the issue of the one year statute of limitations; (2) the issue of the proper party plaintiff; (3) the issue of loss causation;

(4) the issue of whether section 17 of the securities act applies to private parties; (5) The issue of whether section 12(2) of the securities act applies to private placements; and (6) the issue of whether the plaintiff has pled fraud with sufficient particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure.

These issues were presented to the court by way of several motions. Specifically, Tongasat's motion to dismiss the amended complaint, filed on October 31, 1995; the Hilliards' motion to dismiss or alternative motion for summary judgment, filed on October 31, 1995; Nilson's motion to dismiss the amended complaint; filed on January 2, 1996; Nilson's motion for summary judgment filed on October 29, 1996 (and joined by defendants Simon, Sternberg, Tongasat and Pritchard); Hilliard's motion for summary judgment filed on November 11, 1996; NRC's motion for summary judgment filed on November 5, 1996; Simon and Sternberg's motion for summary judgment filed on November 6, 1996; and the Tongasat defendants' motion for summary judgment filed on November 8, 1996.

In the interest of promoting a possible settlement of part or all of this case, this court has specifically undertaken the task of dealing with the six issues noted above. In examining the briefs pertaining to these issues, it became clear that issues pertaining to subject matter jurisdiction needed to be initially addressed. Further, it became apparent that a resolution of several other major issues contained in the motions identified above would facilitate the overall management of this case. That is, by ruling on the major issues in this case, even after finding lack of subject matter jurisdiction, the parties are afforded the opportunity to pursue an orderly appeal of the major

issues in this case, if they so desire. Additionally, ruling on all of these issues at the present time saves considerable court time.

Likewise, in the interest of making the best use of everyone's time and resources, the court did not decide each and every claim raised in the identified motions. Many of the issues were redundant, such as multiple theories of lack of jurisdiction, and many other issues were peripheral to the main issues and were essentially resolved by the court's rulings on the main issues. Also most (if not all) of the remaining motions are effectively mooted by the court's orders, as such motions relate primarily to numerous cross-claims and counter-claims asserted by the various parties to this action.

In light of the decisions entered herewith, Kauthar's "Motion for Decision" is hereby DEEMED MOOT.

Enter: April 14 1997

s/ William C. Lee
William C. Lee, Chief Judge
United States District Court

APPENDIX D — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF INDIANA, FORT WAYNE DIVISION FILED APRIL 14, 1997

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

CIVIL NO. 1:95cv199

KAUTHAR SDN BHD, a Malaysian corporation,

Plaintiff,

v.

MICHAEL A. STERNBERG, *et al.*,

Defendants.

ORDER

This matter is before the court on several issues that have been presented by way of several motions to dismiss filed by the various defendants. Specifically, this order will address the issues of subject matter jurisdiction over plaintiff's claims of securities fraud, whether certain claims are barred by the statute of limitations, and whether the plaintiff has plead fraud with sufficient particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure.

Standard for Motion to Dismiss

In deciding a motion to dismiss for failure to state a claim, this court must take the well pleaded factual allegations of the

plaintiff's complaint as true. *Ashbrook v. Hoffman*, 617 F.2d 474 (7th Cir. 1980). The complaint must be considered in the light most favorable to the plaintiff and every doubt must be resolved in the plaintiff's favor. *Gomez v. Illinois State Board of Education*, 811 F.2d 1030, 1039 (7th Cir. 1987); *Vaden v. Village of Maywood, Illinois*, 809 F.2d 361, 363 (7th Cir.), *cert denied*, 107 S.Ct. 2489 (1987); *Henry C. Beck Co. v. Fort Wayne Structural Steel*, 701 F.2d 1221 (7th Cir. 1983). Dismissal is improper "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Strauss v. City of Chicago*, 760 F.2d 765, 767 (7th Cir. 1985) (quoting *Conley v. Gibson*, 355 U.S. 41 (1957)). Nonetheless, a complaint "must state either direct or inferential allegations concerning all of the material elements necessary for recovery under the relevant legal theory." *Papapetropoulous v. Milwaukee Transport Service*, 795 F.2d 591, 594 (7th Cir. 1986). "The heavy costs of modern federal litigation . . . counsel against launching the parties into pretrial discovery if there is no reasonable prospect that the plaintiff can make out a cause of action from the events narrated in the complaint." *Sutliff, Inc. v. Donovan Companies, Inc.*, 727 F.2d 648, 654 (7th Cir. 1984).

Discussion

The issues presently before this court arise out of the following factual scenario, as summarized from the plaintiff's First Amended Complaint. Rimsat, Ltd. ("Rimsat"), a Nevis corporation headquartered in Fort Wayne, Indiana, leased to its customers transponder capacity on geostationary communications satellites for video, voice, and data transmission within the Pacific Rim and contiguous areas. Amended Complaint ¶14 at 6. The plaintiff, Kauthar Sdn Bhd

("Kauthar"), a Malaysian corporation, purchased certain Rimsat securities on April 12, 1993, and assumed half of the positions on Rimsat's Board of Directors. *Id.* ¶1 at 2, ¶¶102-103 at 52-53.

Rimsat was placed into bankruptcy on or about January 27, 1995. *Id.* ¶110 at 87. Six weeks later, on or about March 10, 1995, Kauthar filed an 80-page complaint against 12 defendants, alleging 23 counts of securities fraud, RICO, and miscellaneous common law claims. Eight of the defendants have raised common issues in various motions. These eight defendants are: Carl Hilliard, Jr.; Sharon Hilliard ("the Hilliards"); Matt C. Nilson; Nilson Research Corp. ("the Nilson defendants"); Friendly Islands Communications Satellite, Ltd.; Her Royal Highness Princess Salote M. Pilolevu Tuita; Jerry Fletcher; and W.L.Pritchard & Co., Inc. ("the Tongasat defendants")[1].

In Counts I, III, IV and V, Kauthar asserts claims against the defendants for violations of Sections 12 and 17 of the 1933 Act, 15 U.S.C. §§ 77i, 77q, Sections 10(b) and 20(a) of the 1934 Act and Rule 10b-5 thereunder, 15 U.S.C. §§78j(b), 78(t); 17 CFR §240.10b-5, and Indiana securities laws, based upon primary and secondary theories of liability as well as upon common law principles of *respondeat superior*.

In support of their request for dismissal, the defendants assert that this court does not have subject matter jurisdiction over the securities fraud counts. The courts in the Seventh Circuit employ two tests in deciding whether to exercise subject matter jurisdiction over an alleged transnational securities fraud

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1. The other four defendants are: Michael Sternberg, James Simon, Denise Simon, and Larry Risser.

violation — the "conduct" test and the "effects" test.[2] *Tamari v. Bache & Co.*, 547 F. Supp. 309, 311 (N.D. Ill. 1982), *aff'd* 730 F.2d 1103 (7th Cir. 1984). Most courts find that jurisdiction exists where either the conduct or the effects test is met. *Peters v. Welsh Dev. Agency*, 1987 WL 12931 (N.D. Ill. Jun. 23, 1987).

"Under the effects test, courts sustain jurisdiction over conduct occurring in foreign countries when that conduct causes foreseeable and substantial harm to interests within the United States, that is, when there is a substantial impact on domestic investors or on the domestic market." *Tamari*, 547 F. Supp. at 311. Moreover, "the need for plaintiffs to demonstrate a particularized harm to domestic interests only arises when domestic investors or exchanges are not directly involved." *Id.* at 313. The defendants contend that Kauthar is a foreign investor and the stock that it purchased was not traded on any American markets. Thus the defendants assert that Kauthar must show a "particularized harm" to domestic interests in order to meet the effects test. The defendants argue that Kauthar has not alleged *any* influence upon domestic markets, much less a "particularized harm" to American markets or investors.

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2. The effects test derives from section 18 of the Restatement (Second) of Foreign Relations Law of the United States (1965), and focuses on whether conduct occurring outside the United States causes foreseeable and substantial effects within the United States. *See Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906, 89 S.Ct. 1747, 23 L.Ed.2d 219 (1969). The conduct test derives from section 17 of the Restatement and focuses on the significance of conduct within the United States to the accomplishment of illegal activities. *See Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Bersch v Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied sub nom. Bersch v Arthur Andersen & Co.*, 423 U.S. 1018, 96 S.Ct. 453, 46 L.Ed.2d 389 (1975).

In response, Kauthar first contends that the "effects test" is not particularly applicable to the present case because jurisdiction is proper under the "conduct test". Kauthar further argues that the Prospectus upon which Kauthar relied was distributed to potential investors in more than 13 states over a period of approximately 18 months. Kauthar further asserts that the defendants provided information included in the Prospectus and contributed to the preparation of the Prospectus. Citing to *Consolidated Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252 (2d Cir. 1989), Kauthar argues that such activity has been held sufficient to confer subject matter jurisdiction under the effects test.

In *Gold Fields*, the issue was "the extent to which an American court may apply the anti-fraud provisions of American securities laws to a tender offer involving two foreign corporations and occurring on foreign soil, where only a small percentage of the target's shareholders are American residents." In *Gold Fields*, the court found jurisdiction over the transaction because the defendants knew that the foreign nominees of American shareholders were required to forward tender offer documents to shareholders and banks located in the United States. *Id.* at 262. The court stated:

> This "effect" (the transmittal of documents by the nominees) was clearly a direct and foreseeable result of the conduct outside the territory of the United States. *Third Restatement*, *supra*, §402(1)(c). If in *Bersch* we could say that Congress intended American antifraud laws to apply to a transaction involving 41,936 shares owned by 22 American residents, then surely we must come to the same conclusion here, where American residents

> representing 2.5% of Gold Fields' shareholders owned 5.3 million shares with a market value of about $120 million.

Kauthar interprets the *Gold Fields* decision as standing for the proposition that even the mere transmittal of documents by a foreign entity to the United States is sufficient to confer subject matter jurisdiction.

The defendants, however, argue that *Gold Fields* differs from the case at bar in two important ways. First, unlike the plaintiff in *Gold Fields*, Kauthar, the allegedly defrauded party, is not alleged to have any American investors. In *Gold Fields*, the court underscored the fact that "the American shareholders in Gold Fields' ADRs hold direct interests in the allegedly defrauded company." *Id.* at 263. Second, the transaction at issue here, unlike the transaction at issue in *Gold Fields*, did not involve or affect American investors or markets.

Kauthar attempts to fit within the *Gold Fields* analysis by pointing out that dozens of American investors in 13 states invested monies in Rimsat stock after having been solicited to do so via a Rimsat Prospectus *substantially the same as* the Prospectus used to induce Kauthar to invest in the Rimsat securities[3]. However, as the defendants point out, the law is clear that "[f]oreign plaintiffs, however, cannot sustain their

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3. Kauthar also relies on *MCG, Inc. v. Great Western Energy Corp.*, 896 F.2d 170, 174 (5th Cir. 1990), in which the court held that the effects test was applicable to "conduct occurring outside the United States that has an effect on the American securities markets or American investors." In *MCG*, the plaintiffs were American investors. Nevertheless, the court found jurisdiction lacking as the plaintiffs had structured the transaction to avoid the American securities laws.

claims on the basis that American investors have cognizable claims." *Alfadda v. Fenn*, 751 F. Supp. 1114, 1119 (S.D.N.Y. 1990), *rev'd on other grounds*, 935 F.2d 475 (2d Cir. 1991) (finding jurisdiction under the conduct test instead of the effects test). Moreover, Kauthar has not even alleged that the specific transaction at issue affected American investors.

In *Bersch v. Drexel Firestone, Inc.*, the court severed the claims of American plaintiffs from those of foreign plaintiffs and found that jurisdiction existed under the effects test only over the Americans' claims. 519 F.2d 974, 990-92 (2d Cir. 1975). The *Bersch* court concluded that "the anti-fraud provisions of the federal securities laws . . . . [d]o not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses." *Id.* at 992.

It is clear to this court that Kauthar has failed to meet the effects test, as it has failed to show that the transaction at issue (which actually arose out of a *private* placement memorandum[4]) had a substantial impact on domestic investors or the domestic market. *See Tamari*, *supra*, 547 F. Supp. at 311. Thus, the analysis now turns to the conduct test.

> The conduct test looks to the defendant's activities in the United States in light of the overall fraud. Preparatory acts will not suffice; rather, the acts must directly cause the losses alleged. *Continental Grain*, 592 F.2d at 420; *accord Tamari I*, 547 F. Supp. at 314. Jurisdiction may be warranted where the foreign defendant has transmitted

4. It is undisputed that Rimsat's stock is not traded on any American exchange.

> messages into the United States by wire or mail, if those transmissions accompany other acts within the United States.

Peters v. Welsh Development Agency, 1987 WL 12931, at *5 (N.D. Ill. 1987).

Kauthar alleges that the defendants communicated with Kauthar by wire and through United States and international mails, that the "installment payments (in connection with the purchase of "Class D" shares] were made . . . by wire transfer from Kauthar's account in Malaysia to Rimsat's account in Fort Wayne, Indiana," and that the Prospectus, Subscription Agreement, monthly income (loss) statements and correspondence were delivered to Kauthar by United States mail. Amended complaint ¶76-77 at 24; ¶102 at 52; ¶109(s) at 85; ¶109(c)-(f) at 80-81.

The defendants, in response, assert that none of the transmissions sent into the United States were accompanied by other acts within the United States and, moreover, none of the transmissions directly caused the alleged losses, and therefore are not sufficient to confer subject matter jurisdiction. The defendants also point out that Kauthar has attempted to establish a connection with the United States by alleging that some unspecified portion of the materials were prepared in the United States. Amended Complaint ¶79 at 25. The defendants argue that any such alleged conduct was merely preparatory to the alleged fraud, and is insufficient to confer subject matter jurisdiction.

Kauthar, however, further claims that it has properly and sufficiently alleged that the defendants engaged in other conduct

and activities within the United States which caused or contributed to Kauthar's losses such that this court has jurisdiction. Specifically, Kauthar has alleged that Tongasat did business in Fort Wayne (Complaint at ¶6), the Tongasat defendants participated in the day-to-day operations of Rimsat through Nilson (Complaint at ¶5), the Princess was Nilson's "boss" (Complaint at ¶13), the Tongasat defendants held a 25% interest in Rimsat (Complaint at ¶45), the Tongasat defendants received payments, none of which were identified in the Prospectus, from Rimsat through PTI and/or Nilson (Complaint at ¶48), and the Tongasat defendants sought and obtained significant cash payments from Rimsat, the source of the cash for such payments being, in large part, Kauthar's investment.

> The conduct test bases jurisdiction on conduct occurring within the United States. The residence or citizenship of the parties and the foreign or domestic nature of the securities involved, while relevant, is not the focus of inquiry; instead the courts concentrate on the relative importance of activities within the United States to the success of the alleged scheme to defraud. If such conduct is substantial rather than merely preparatory, incidental or fortuitous, the courts are more likely to find jurisdiction.

Tamari v. Bache & Co. (Lebanon) S.A.L., 547 F. Supp. 309, 313-14 (N.D. Ill. 1982).

Thus, while there is no doubt that *conduct* occurred in the United States, the question is whether such conduct was *substantial*, in that it was important to the success of the alleged scheme to defraud. Kauthar has alleged numerous instances of

conduct occurring in the United States, but has failed to show how such conduct is substantial in relation to the transaction at issue. Kauthar claims that *Psimenos v. E. F. Hutton*, 722 F.2d 1041 (2d Cir. 1983), a case relied on by the defendants, actually supports its position. Kauthar has obviously misread *Psimenos*. The issue in *Psimenos* was whether trading in United States commodities markets is sufficient to confer subject matter jurisdiction on a federal district court to hear a claim for damages brought by an alien under the Commodities Exchange Act. 722 F.2d at 1044. Specifically, the *Psimenos* court held:

> We find that the district court has jurisdiction to hear Psimenos' claim. The trades Hutton executed on American markets constituted the final act in Hutton's alleged fraud on Psimenos, without which Hutton's employees could not have generated commissions for themselves. Coming as they did as the culminating acts of the fraudulent scheme, such trading could hardly be called "preparatory activity" not subject to review under the anti-fraud provisions of the CEA. *ITT v. Vencap, Ltd.*, 519 F.2d 1001, 1018 (2d Cir. 1975). On the contrary, Hutton's trades in the United States, involving domestic futures contracts, were material acts that directly caused Psimenos' claimed losses.

Id.

The court further stated:

> We find under the conduct test, Hutton's activities in the United States in furtherance of the alleged fraud were substantial enough to establish

> subject matter jurisdiction. First, Hutton's pamphlet, promising continual supervision of highly qualified managers, emanated from Hutton's New York office. This may be considered substantial if, as Psimenos claims, it induced him to open and maintain an account with Hutton. See *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 103-04 (7th Cir. 1977). That by itself, however, would not be enough to sustain jurisdiction. *Cf. Bersch*, *supra*, at 985 n.24. Far weightier is the fact that Hutton's agents completed the alleged fraud by trading domestic futures contracts on American commodities exchanges.

Id. at 1046.

Clearly, *Psimenos* does not support Kauthar's argument that this court has subject matter jurisdiction over the securities fraud claims. In the transaction at issue, trading did not take place in American markets. Additionally, the conduct Kauthar relies on is general in nature (doing business in the U.S.; participating in day-to-day operations of Rimsat, etc.) and cannot be called "culminating acts of the fraudulent scheme", by any stretch of the imagination. Consequently, as Kauthar has failed both the effects test and the conducts test, this court finds that it does not have jurisdiction over the securities fraud claims.

Nevertheless, this court will also discuss the defendants' argument that the claims in Count I and Count IV are barred by the statute of limitations. In its amended complaint, Kauthar has asserted claims under §12(2) of the 1933 Act as well as under §10(b) and Rule 10b-5 of the 1934 Act. The defendants

argue that these claims are time-barred by the one-year statute of limitations for each Act.

Section 13 of the 1933 Act, which establishes the applicable statute of limitations brought under §12(2), provides that a §12(2) claim must "be brought within one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence", and in no event shall be brought "more than three years after the sale" 15 U.S.C. § 77m (1988). A plaintiff must do more than merely file an action under §12(2) within the limitations period in order to meet the demands of §13. That is, a plaintiff has affirmative pleading responsibilities:

> Section 13 is not an ordinary statute of limitations. The courts have repeatedly held that compliance with the time provisions of §13 of the Securities Act, in contrast to other limitations statutes, is an essential element of a cognizable §12(2) claim. Thus, unlike other situations, compliance with the statute must be affirmatively pled in §12(2) actions and is not merely an affirmative defense to be raised by defendants.

Ambling v. Blackstone Cattle Co., Inc., 658 F. Supp. 1459, 1462 (N.D. Ill. 1987). *See also Fisher v. Samuels*, 691 F. Supp. 63, 71 (N.D. Ill. 1988). The "complaint must set forth the time and circumstances of discovery of the untrue statement or omission, state the reasons why discovery was delayed if more than one year has elapsed since the statement or omission was made, and describe plaintiff's diligent efforts to seek discovery." *In re VMS Securities Litigation*, 752 F. Supp. 1373, 1384-85 (N.D. Ill. 1990). *See also In re Integrated Resources Real Estate Ltd. Partnerships Sec. Litig.*, 815 F. Supp. 620, 631 (S.D.N.Y. 1993).

Appendix D

The defendants acknowledge that Kauthar has specified the time and circumstances of its discovery of the alleged fraud in its amended complaint. However, the defendants argue that Kauthar's amended complaint does not explain *why* discovery was delayed for months after the expiration of the one-year statute of limitations or describe Kauthar's work efforts to seek discovery.

The statute of limitations for actions brought under §10(b) of the 1934 Act and Rule 10b-5 thereunder is one year. *Lampf, Pleva, Linkind, Prupis & Petgrow v. Gilbertson*, 111 S.Ct. 2773, 2782 (1991). The one-year period begins to run "when the victim of the alleged fraud becomes aware of facts that would have led a reasonable person to investigate whether he might have a claim ('inquiry notice'). . . ." *Treganza v. Great American Communications Co.*, 12 F.3d 717, 718, 722 (7th Cir. 1993).

Thus, for claims under Rule 10b-5, as well as under §12(2) of the 1933 Act, commencement of the running of the statute of limitations is not dependent on a party's receipt of actual notice of an alleged fraud. "Inquiry notice is sufficient to begin the limitations clock." *Whirlpool Financial Corp. v. GN Holdings, Inc.*, No. 95-1292, 1995 WL 571397, at *3 (7th Cir. Sept. 28, 1995). *See also Donohoe v. Consolidated Operating & Production Corp.*, 982 F.2d 1130, 1141 (7th Cir. 1992) (statute begins to run when "the buyer is on 'inquiry notice' of the potential for fraud").

Victims of the alleged fraud are on inquiry notice and must diligently investigate when they become "aware of facts that would have led a reasonable person to investigate whether he or she might have a claim." *Whirlpool Financial Corp. v. GN*

Holdings, 873 F. Supp. 111, 124 (N.D. Ill. 1995), *aff'd*, No. 95-1292, 1995 WL 571397 (7th Cir. Sept. 28, 1995). A plaintiff cannot "ignore obvious danger signs" that give rise to suspicions of fraud, *Fisher*, 691 F. Supp. at 72 (citation omitted), and is "not entitled to nail down 'every last detail of a transaction' before . . . [being] charged with knowledge sufficient to start the running of the limitations period." *Donohoe*, 982 F. 2d at 1141.

Kauthar has conceded that it "learned of the allegation of the payment by Rimsat of the so-called Chesden finder's fee in approximately September 1993". Amended Complaint ¶119 at 67. Moreover, Kauthar repeatedly stresses that the Chesden commission is, in its view, a critical component of the fraud that it is trying to establish. *See e.g.*, ¶19 at 7; ¶72 at 22-23; ¶91(k) at 41; ¶100(a) at 48; ¶119 at 67; and ¶109(e) & (g) at 80-81. The defendants point out that Kauthar states in its amended complaint that "Hilliard in correspondence dated September 1, 1993, wrote Kauthar . . . that he had never received any monies from the so-called Chesden finder's fee." Count IV, ¶119 at 67. The defendants argue that reliance on this reassurance, however, would not excuse ignoring the facts that gave rise to their suspicions. *See Fisher*, 691 F. Supp. at 72. Thus, the defendants argue that not only did Kauthar have "inquiry notice" in September 1993, more than a year before it filed this lawsuit on March 12, 1995, but also that Kauthar actually initiated an investigation in September 1993. Yet Kauthar waited more than a year after commencing its investigation before it filed this action.

In response, Kauthar asserts that it has plead ample facts to demonstrate the timeliness of its claims. Specifically, Kauthar points out that it alleges that it did not "reasonably learn of the

falsity of the representations contained in Paragraphs 91(e)-(k) and 92-99, or of the omissions described in Paragraph 100(b)-(p) of its Complaint until February, 1995, when it conducted an investigation, after [which] Rimsat unexpectedly filed for bankruptcy on approximately January 27, 1995." Amended Complaint at ¶117. Kauthar argues that the reasonable inference to be drawn from the filing of the bankruptcy in January 1995 is that, at that time, Kauthar became privy to information heretofore unavailable or purposely concealed from Kauthar.

Additionally, Kauthar points out that its Amended Complaint states that it did not reasonably learn of the falsity of the representations contained in Paragraphs 91(a)-(b) and 91(1)-(p), or of the omissions described in Paragraph 100(a) of the Amended Complaint until it received a copy of the filed Complaint and investigated the allegations contained therein brought by Rimsat against Hilliard, Cause No. 1:94cv72, filed on March 11, 1994. Kauthar argues that, accepting this allegation as true for purposes of the present motion, Kauthar has clearly filed the present claims well within one year after the earliest it could have become aware of the misrepresentations and omissions which form the basis of its claim. Kauthar also argues that the reasonable inference to be drawn from the filing of the Rimsat complaint against Hilliard is that, at that time, Kauthar became privy to and was able to uncover, through its investigations of the allegations contained therein, documents and information heretofore undisclosed and purposely concealed from Kauthar.

With respect to the defendants' argument that Kauthar was placed on inquiry notice by knowledge of the Chesden finder's fee, Kauthar argues that the real issue is that it did not learn of the payment of a finder's fee to insiders (Nilson, Risser,

Hilliard, Fletcher, the Princess and others) until some time after March 11, 1994, when the *Rimsat v. Hilliard* lawsuit was filed.

Kauthar argues that the allegation that Rimsat paid the Chesden finder's fee did not provide Kauthar "with sufficient storm warnings to alert a reasonable person to the [probability] that there were either misleading statements or significant omissions involved in the sale of the [securities]." *In re Integrated Resources Real Estate Sec. Lit.*, 815 F. Supp. 620, 639 (S.D.N.Y. 1993). Thus, while Kauthar acknowledges that it knew that a finder's fee had been paid to Chesden, a Hong Kong corporation, Kauthar argues that it was not until the Rimsat bankruptcy that Kauthar first learned that the finder's fee was shared by Hilliard, Nilson, Fletcher and the Princess — all of whom were insiders.

In reply, the defendants argue that Kauthar is glossing over one important fact: After learning of the Chesden's finders fee, Kauthar launched an investigation and then ceased its investigation when Hilliard "wrote to Kauthar by United States and international mails that he had never received any monies from the so-called Chesden finder's fee." Amended Complaint at ¶119 at 67. The defendants argue that Kauthar completely fails to explain why, based on Hilliard's letter alone, it decided to halt its investigation, thus ignoring the "storm warning" that aroused its suspicions.

This court agrees with the defendants on this issue. Kauthar's amended complaint places much emphasis on the Chesden finders fee in support of its fraud claims. Additionally, Kauthar has acknowledged that it began an investigation, but halted its investigation after receiving Hilliard's letter. Yet, as the defendants point out, Kauthar has not explained how this

single letter sufficiently doused its suspicions such that it completely called off its investigation. Pursuant to *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 352 n.3 (2d Cir. 1993), this court may decide as a matter of law whether Kauthar received inquiry notice. Based on the foregoing, this court finds that Kauthar received inquiry notice in September 1993, more than a year before it filed the present lawsuit. Consequently, Kauthar's claims under §10(b) of the 1934 Act and §12(2) of the 1933 Act are barred by the statute of limitations.

The defendants have also argued that Kauthar has failed to plead its fraud claims with particularity. Rule 9(b) of the Federal Rules of Civil Procedure provides that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Fed.R.Civ.P. 9(b). The heightened specificity requirements of Rule 9(b) apply to claims of fraud under the federal securities laws. *Sears v. Likens*, 912 F.2d 889, 893 (7th Cir. 1990). The defendants argue that those portions of Kauthar's complaint alleging violations of Section 12(2) (and apparently, Section 15) of the 1933 Act, and Sections 10(b), 20(a) and Rule 10b-5 of the 1934 Act, do not satisfy Rule 9(b).

In accordance with Rule 9(b), courts in the Seventh Circuit have consistently required plaintiffs in fraud cases to distinguish among defendants and state with specificity which defendant made which alleged representation. As the Seventh Circuit stated:

> A complaint that attributes misrepresentations to all defendants, lumped together for pleading purposes, generally is insufficient.

Sears v. Likens, 912 F.2d at 893 (*quoting Design Time, Inc. v. Synthetic Diamond Technology, Inc.*, 674 F. Supp. 1564, 1569 (N.D. Ind. 1987)). *See also Coronet Ins. Co. v. Seyfarth*, 665 F. Supp. 661, 666 (N.D. Ill. 1987) ("[p]laintiffs may not 'lump' defendants together in general allegations of fraudulent activity, implying that each defendant is responsible for the statements and actions of others") (citations omitted); *Adair v. Hunt International Resources Corp.*, 526 F. Supp. at 744-45; *Lincoln National Bank v. Lampe*, 414 F. Supp. at 1278; *D&G Enterprises v. Continental Ill. Nat. Bank*, 574 F. Supp. 263, 267 (N.D. Ill. 1983) (complaint must inform each defendant of its specific fraudulent act); *McKee v. Pope Ballard Shepard & Fowle, Ltd*, 604 F. Supp. 927, 931 (N.D. Ill. 1985) ("[t]he identity of those making the misrepresentations is crucial") .

The defendants claim that in its original complaint, Kauthar set forth the purportedly fraudulent statements by one or more persons whom Kauthar grouped as "Rimsat's promoters and controlling persons". Kauthar provided no specifics regarding the alleged role, if any, of the individual defendants. The defendants pointed out this deficiency in their original motion to dismiss. Now, in its amended complaint, Kauthar asserts that the Tongasat defendants are implicated through the conduct of defendant Matt Nilson, who, Kauthar repeatedly alleges, acted "on behalf of" the Tongasat defendants. *See, e.g.*, Amended Complaint ¶5 at 3.

The defendants argue that Kauthar's effort to make Nilson the linchpin for the Tongasat defendants adds verbiage to the Amended Complaint, but does not further particularize it. That is, the defendants argue that the Amended Complaint still "lumps" the defendants together, improperly "implying that each defendant is responsible for the statements and actions of

others". *See Coronet*, 665 F. Supp. at 666. The defendants point out that this is precisely the type of vagueness that the courts in this Circuit have repeatedly struck down under Rule 9(b). *Sears*, 912 F.2d at 893 (§12(2) claim under the 1933 Act dismissed for failure to state in detail which misrepresentations were made by which defendant); *D&G Enterprises*, 574 F. Supp. at 267-68 (same); *Design Time*, 674 F. Supp. at 1569 (claims under §10 of 1934 Act and Rule 10b-5 dismissed for lack of particularity); *Lincoln Nat. Bank*, 414 F. Supp. at 1278 (same).

In support of their position that Kauthar has improperly lumped together all of the defendants, the defendants quote, as an example, the Amended Complaint at ¶106 at 53-54:

> Hilliard, Nilson, both individually and on behalf of Tongasat, NRC, S. Hilliard, Tongasat, the Princess and Fletcher, Sternberg and Risser, individually, together, and as agents of each other, or some combination of the above defendants . . . had the power and influence to direct Rimsat, Simon and Nilson, and/or the other Defendants primarily liable, to make or not to make the misrepresentations and omissions alleged herein.

The defendants compare Kauthar's Amended Complaint to the complaint in *Adair*, 526 F. Supp. at 744, wherein the plaintiff lumped all defendants and representations together, apparently attempting to imply, by vague allegations of agency, that each defendant was responsible for statements made by others. The defendants contend that Kauthar cannot meet the particularity requirements of Rule 9(b) because the Amended Complaint "goes no further toward identifying the role each defendant played in the alleged scheme. It is not enough." *Adair*, 526 F. Supp. at 745.

In response, Kauthar argues that the defendants have failed to reconcile the interplay between Rule 8 (requiring short, plain and concise statements of a claim) and Rule 9(b). *Tomera v Galt*, 511 F.2d 504, 508 (7th Cir. 1975); *Bruss v. Allnet Communications Services, Inc.*, 606 F. Supp. 405 (N.D. Ill. 1985). Rules 8 and 9 together require that, in a fraud action, a plaintiff must plead with particularity the circumstances constituting the fraud, including the time and place of the fraud, the contents of the omissions or misrepresentations and the identity of the party or parties perpetrating the fraud. However, the plaintiff need not plead detailed evidentiary matters. *Bruss*, 606 F. Supp. at 405.

Kauthar claims that the defendants have ignored the many facts in its Amended Complaint which delineate the roles and participation of the defendants in the scheme to defraud. While it is true that some of the paragraphs in the Amended Complaint detail the activities of the defendants separately[5], many of the paragraphs (some of which run for over five pages) of the Amended Complaint simply list allegedly fraudulent omissions and concealments, without ever attributing a specific representation to a specific defendant[6]. The standard to be applied to the Amended Complaint as a whole is whether the defendants could "determine from the complaint which of the representations or omissions [they are] specifically charged with having made, or what role [they are] alleged to have played in the fraud." *Coronet*, 665 F. Supp. at 666.

While "[t]here may be specific matters as to which it is appropriate to refer to some defendants collectively", Kauthar

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5. *See e.g.*, ¶¶65, 66, 67, 70, 72.

6. *See e.g.*, ¶¶ 39, 47, 59, 60, 65, 67, 72-74, 76, 77, 91-98, 100, 101, 104, 105-106, 111, 114-115, 117-118.

nevertheless owes the defendants "the obligation to make a good faith differentiation throughout the complaint which will enable each defendant to know with what he or it is charged and to what he or it must make answer." *Id.* at 666-67 (*quoting Kennedy v. Nicastro*, 503 F. Supp. 1116, 1122 (N.D. Ill. 1980)). It is clear in the present case that although Kauthar has set forth some of its fraud allegations with some degree of particularity, a vast portion of Kauthar's allegations fail to state the factual basis underlying each defendant's culpability. Thus, it cannot be said that each defendant has sufficient notice of the conduct complained of to prepare a defense. *Bruss Co. v. Allnet Communications Services, Inc.*, 606 F. Supp. 401, 404-05 (N.D. Ill. 1985); *D&G Enterprises v. Continental Illinois National Bank*, 574 F. Supp. 263, 266-67 (N.D. Ill. 1983); *Adair v. Hunt International Resources Corp.*, 526 F. Supp. 736, 744 (N.D. Ill. 1981). Accordingly, Kauthar's claims of fraud will be dismissed for failure to comply with Rule 9(b).

Conclusion

For all of the foregoing reasons, Kauthar's securities fraud claims are hereby DISMISSED for lack of subject matter jurisdiction. Further, Kauthar's securities claims asserted in Count I and Count IV of its Amended Complaint are hereby DISMISSED as barred by the statute of limitations. Further, Kauthar's fraud claims are hereby DISMISSED for failure to comply with the requirements of Rule 9(b) of the Federal Rules of Civil Procedure.

Enter: April 14, 1997.

s/ William C. Lee
William C. Lee, Chief Judge
United States District Court

APPENDIX E — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF INDIANA, FORT WAYNE DIVISION FILED APRIL 14, 1997

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

CIVIL NO. 1:95cv199

KAUTHAR SDN BHD, a Malaysian corporation,

Plaintiff,

v.

MICHAEL A. STERNBERG, *et al.*,

Defendants.

ORDER

This matter is before the court on several issues that have been presented by way of several motions to dismiss filed by the various defendants. Specifically, this order will address issues related to plaintiff's claims under Sections 17(a) and 12(2) of the Securities Act of 1933, and issues related to plaintiff's claims pursuant to the RICO statute.

Standard for Motion to Dismiss

In deciding a motion to dismiss for failure to state a claim, this court must take the well pleaded factual allegations of the plaintiff's complaint as true. *Ashbrook v. Hoffman*, 617 F.2d

474 (7th Cir. 1980). The complaint must be considered in the light most favorable to the plaintiff and every doubt must be resolved in the plaintiff's favor. *Gomez v. Illinois State Board of Education*, 811 F.2d 1030, 1039 (7th Cir. 1987); *Vaden v. Village of Maywood, Illinois*, 809 F.2d 361, 363 (7th Cir.), *cert. denied*, 107 S.Ct. 2489 (1987); *Henry C. Beck Co. v. Fort Wayne Structural Steel*, 701 F.2d 1221 (7th Cir. 1983). Dismissal is improper "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Strauss v. City of Chicago*, 760 F.2d 765, 767 (7th Cir. 1985) (quoting *Conley v. Gibson*, 355 U.S. 41 (1957)). Nonetheless, a complaint "must state either direct or inferential allegations concerning all of the material elements necessary for recovery under the relevant legal theory." *Papapetropoulous v. Milwaukee Transport Service*, 795 F.2d 591, 594 (7th Cir. 1986). "the heavy costs of modern federal litigation . . . counsel against launching the parties into pretrial discovery if there is no reasonable prospect that the plaintiff can make out a cause of action from the events narrated in the complaint." *Sutliff, Inc, v. Konovan Companies, Inc.*, 727 F.2d 648, 654 (7th Cir. 1984).

Discussion

The issues presently before this court arise out of the following factual scenario, as summarized from the plaintiff's First Amended Complaint. Rimsat, Ltd. ("Rimsat"), a Nevis corporation headquartered in Fort Wayne, Indiana, leased to its customers transponder capacity on geostationary communications satellites for video, voice, and data transmission within the Pacific Rim and contiguous areas. Amended Complaint ¶14 at 6. The plaintiff, Kauthar Sdn Bhd ("Kauthar"), a Malaysian corporation, purchased certain Rimsat

securities on April 12, 1993, and assumed half of the positions on Rimsat's Board of Directors. *Id.* ¶1 at 2, ¶¶102-03 at 52-53.

Rimsat was placed into bankruptcy on or about January 27, 1995. *Id.* ¶110 at 87. Six weeks later, on or about March 10, 1995, Kauthar filed an 80 page complaint against 12 defendants, alleging 23 counts of securities fraud, RICO, and miscellaneous common law claims. On September 29, 1995, Kauthar filed an 113-page amended complaint, alleging 22 counts of securities fraud, RICO, and miscellaneous common law fraud, against the same 12 defendants. Eight of the named defendants have raised common issues in various motions. These eight defendants are: Carl Hilliard, Jr.; Sharon Hilliard ("the Hilliards") ; Matt C. Nilson; Nilson Research Corp. ("the Nilson defendants"); Friendly Islands Communications Satellite, Ltd.; Her Royal Highness Princess Salote M. Pilolevu Tuita; Jerry Fletcher; and W.L. Pritchard & Co., Inc. ("the Tongasat defendants").[1]

Count III of Kauthar's complaint asserts a cause of action under Section 17(a) of the Securities Act of 1933. Kauthar has acknowledged, both in its complaint and its brief, that the Seventh Circuit Court of Appeals has held that there is no private right of action under Section 17(a). *Sears v. Likens*, 912 F.2d 889, 893 (7th Cir. 1990); *Schlifke v. SeaFirst Corp.*, 866 F.2d 935 (7th Cir. 1989).

Therefore, Kauthar has anticipated that Count III will be dismissed, and merely asserts the claim so as to preserve its right to appeal the dismissal of Count III in the event the United States Supreme Court, acting on a split in the circuits on this

1. The other four defendants are: Michael Sternberg, James Simon, and Larry Risser.

issue, makes a decision contrary to present Seventh Circuit authority.

In light of current Seventh Circuit authority, Count III of Kauthar's complaint will be dismissed[2].

The defendants next argue that Count IV of Kauthar's complaint fails to state a claim under §12(2) of the 1933 Act because §12(2) does not apply to private sales of stock. In relevant part, §12(2) provides that any person who

> offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, *by means of a prospectus or oral communication*, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know and in the exercise of reasonable care could not have known, of such untruth or omission, "shall be liable to the person purchasing such a security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for

2. The defendants also assert that because there is no primary violation of §17(a), there cannot be any vicarious liability for such a claim. This court also agrees with the defendants on this point.

> such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

There is no dispute that §12(2) of the 1933 Act applies only to public offerings of securities, not to private sales of stock. *Gustafson v. Alloyd Company*, 115 S.Ct. 1061 (1995); *Whirlpool Financial Corporation v. GN Holdings, Inc.*, 1995 WL 571397 (7th Cir. Sept. 28, 1995); *Endo v. Albertine*, 1995 WL 170030 at *6, n.3 (N.D. Ill. April 7, 1995) ("[T]he Supreme Court's recent decision in *Gustafson* . . . limits recovery under §12(2) to only those . . . who purchased securities in a public offering . . . [anyone] who purchased securities pursuant to a private sale agreement, no longer has a §12(2) right of action against any of the defendants").

In *Gustafson*, the Supreme Court ruled that §12(2) of the 1933 Act applies only to the distribution of a "prospectus" which, construed consistently with §2(10) and §10 of the Act, relates only to public offerings of securities, and not to private sales of stock. Specifically, the Supreme Court stated:

> An examination of §10 reveals that, whatever else "prospectus" may mean, the term is confined to a document that, absent an overriding exemption, must include the "information contained in the registration statement." By and large, only public offerings by an issuer of a security, or by controlling shareholders of an issuer, require the preparation and filing of registration statements. See 15 U.S.C. §§77d, 77e, 77b(11). It follows, we conclude, that a prospectus under §10 is confined to documents

> related to public offerings by an issuer or its controlling shareholders. * * * * We conclude that the term "prospectus" must have the same meaning under §§10 and 12.

Id. at 1067. In light of this language, Kauthar does not dispute the definition of a prospectus. Rather, Kauthar argues that the transaction at issue here was a public offering, rather than a private sale of stock. Kauthar contends that the allegations in its complaint demonstrate that the securities were offered pursuant to a public offering and, therefore, should have been registered with the Securities Exchange Commission.

The document related to the offering at issue is entitled "*Confidential — RIMSAT LTD Materials in Support of Private Placement of Equity*". The defendants refer to this document as "private placement materials", however Kauthar describes the document as a "prospectus". The document itself states:

> This information is confidential and proprietary and is delivered on the express condition that such information will not be disclosed to anyone except persons in the recipient's organization who have an actual need to know for purposes of considering the proposed transaction. If the recipient decides not to pursue the proposed transaction, the recipient will return the information together with all copies. No copies or other reproduction of the memorandum may be made without the consent of Rimsat[.]

Amended Complaint ¶91 at 28, Appendix B, "Introduction" at PR 003.

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The defendants argue that a prospectus, as construed by *Gustafson*, is not "private," "proprietary" or "confidential;" nor is its distribution or duplication conditioned on an "as needed" basis; nor would the issuers of a prospectus request its ultimate return. The defendants point out that the Supreme Court specifically held that "[t]he term prospectus refers to a document soliciting the public to acquire securities. . . [It] refers to documents of wide dissemination." *Gustafson*, 115 S.Ct. at 1069-70. Although Kauthar has alleged that the defendants made "oral misrepresentations" and "omissions and concealments", the defendants point out that Kauthar expressly states that these alleged statements were made only to Kauthar, and not to the general public. Amended Complaint at ¶¶92, 94 at 44-45, 100 at 49. Thus, the defendants argue that the general public was not involved with these alleged communications, and thus the statements are not actionable under §12(2).

The defendants claim that Kauthar added allegations to its Amended Complaint in an effort to define the placement materials as a publicly disseminated prospectus. For example in ¶91 at 28-29, Kauthar alleges: "Despite its language, the Prospectus at issue was, upon information and belief, also widely disseminated during the period August 1992, to late 1993, to hundreds of members of the public. . . . Many of the prospective investors . . . had no prior relationship with Simon, Sternberg, Hilliard, Nilson or the others, and many of the solicitations involved 'cold calls'." The defendants argue that even if Kauthar had any basis for these statements made on "information and belief", Kauthar has not and cannot allege that the placement materials were required to satisfy the requirements of §10. As stated in *Gustafson*, "[A] document is not a prospectus within the meaning of [§10] if, absent an exemption, it need not comply with §10's requirements in the first place." 115 S.Ct. at 1067.

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The defendants acknowledge that Kauthar has alleged that "upon information and belief", the "offering to Kauthar was not exempt from registration under the federal securities laws", and that the "Prospectus delivered to Kauthar contains much of the information typically contained in a registration statement." Amended Complaint at ¶¶120, 121 at 68. However, as the defendants point out "allegations made upon information and belief are insufficient [to satisfy the requirements of Rule 9(b)], even if the facts are inaccessible to the plaintiff, unless the plaintiff states the grounds for his suspicions." *Uni*Quality, Inc. v. Infotronx, Inc.*, 974 F.2d 918, 922 (7th Cir. 1992); *Bankers Trust Co. v. Old Republic Ins. Co.*, 959 F.2d 677 (7th Cir. 1992).

The defendants next argue that if Kauthar had any actual basis for alleging that Rimsat's placement materials were distributed, yet not exempt from registration, Kauthar would have asserted a violation of Section 5 of the 1933 Act, which makes it unlawful to utilize the mails or interstate commerce to sell a security unless a registration statement is in effect as to that security. 15 U.S.C. §77e. Additionally, the defendants claim that allegations that the placement materials contained information normally contained in a registration statement are meaningless. The defendants direct the court to *Glamorgan Coal Corp. v. Ratner's Group PLC*, 1995 WL 406167, *1, *3 (S.D.N.Y. 1995), in which a "Final Private Placement Memorandum" consisted of "a 275-page document containing information similar to that found in a public offering prospectus (e.g., financial data, analysis of financial condition, management discussion)." While it is true that the plaintiff in *Glamorgan* conceded that the offering involved there was a private offering, the case is nevertheless important as it shows that a private offering may very well contain detailed information such as would be found in a prospectus.

Kauthar asserts that "it can reasonably be inferred that the offering was not exempt from registration." The defendants, however, point out that Kauthar has not alleged that there occurred any "general solicitation or general advertising," through media such as television, radio, or seminars, or even as an advertisement, article, notice or other communication published in a newspaper or magazine[3]. Nor has Kauthar alleged that the transaction involved the sale of securities to more than 35 unaccredited investors in connection with the transaction[4].

Kauthar alleges in its complaint that previous offerings by Rimsat of Class C shares had to be rescinded because of the failure to register the securities in violation of both State and Federal Securities law. Amended Complaint at ¶37(c). Kauthar further alleges (upon information and belief) that the Class C shareholders who purchased their shares after August 30, 1992, did so in reliance upon material substantially the same in form to that through which Kauthar acquired all of its interests alleged in the amended complaint. Amended Complaint at ¶59. Thus, Kauthar argues that a reasonable inference arises that the offering to Kauthar was also not exempt from registration.

In response to Kauthar's argument, the defendants point out that the placement at issue in the present case was not part of an integrated sale of stock. In fact, Kauthar's amended complaint specifically concedes that its Section 12(2) claims are not based on the transactions that occurred in April through December of 1992. As the transactions were not part of an integrated sale of stock, the allegation that the earlier offering

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3. *See* 17 CFR § 230.502(c), which sets forth a number of considerations for determining whether an offering is public or private.

4. *See* 17 CFR §230.506(b).

of Class C stock[5] was required to be registered is not sufficient to defeat the defendants' motion to dismiss.

The defendants also assert that Counts I and IV of Kauthar's amended complaint should be dismissed for failure to assert a claim for "control person" liability[6]. Section 20 of the 1934 Act provides that:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the acts or acts constituting the violation or cause of action.

15 U.S.C. §78t(a)(1988).

In Counts I and IV of the amended complaint, Kauthar appears to allege that the Tongasat defendants are liable as control persons of Rimsat, Nilson and Simon.

The Tongasat defendants first argue that they cannot be held liable as control persons of Rimsat because Kauthar has not alleged that Rimsat violated the federal securities laws.

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5. It does not appear to be disputed that Kauthar's claim for damages rests on its Class D, not Class C, investment.

6. Kauthar appears to allege that the Tongasat defendants are liable as control persons of Rimsat, Nilson and Simon. Amended Complaint, Counts I, IV, at 57, 66-67.

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Edison Credit Union v. Bevill, Bresler, 1987 WL 15408 at *3 (N.D. Ill. 1987) (no control person liability where complaint did not allege securities law violation by controlled person). The control person provisions in both the 1933 and 1934 Acts premise a finding of control person liability preliminarily upon a finding of primary liability: the controlling person is "liable jointly and severally with and to the same extent" as the entity "liable under any provision of this chapter or of any rule or regulation thereunder." 15 U.S.C. §78t(a) (1988).

Control person liability is derivative, as a controlling person can be liable only if there is an underlying violation of the securities laws. *In re VMS Securities Litigation*, 752 F. Supp. at 1402 ("there can be no controlling person liability without a primary violation"); *FMC Corp. v. Boesky*, 727 F. Supp. 1182, 1199, n.19 (N.D. Ill. 1989) (same); *O'Keefe v. Courtney*, 655 F. Supp. 16, 19 (N.D. Ill. 1985) (same). Accordingly, the Tongasat defendants conclude that because Kauthar has failed to allege primary liability against Rimsat under either the 1933 or the 1934 Acts, they cannot be held liable as controlling persons of Rimsat.

Kauthar, in response, makes the erroneous statement that the defendants are arguing that they are not liable to Kauthar unless Rimsat is sued by Kauthar. However, it is clear that the defendants are not making such an argument. Rather, the defendants are arguing that Kauthar has not *made the allegation* that Rimsat violated the federal securities laws. As the amended complaint is devoid of such an allegation against Rimsat, as Kauthar admits, Kauthar cannot maintain a claim against the Tongasat defendants for "control person liability".

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The defendants further argue that Kauthar has not pled control person liability with sufficient particularity, as required by Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b) serves to put defendants on notice of the alleged wrong with which they are charged, in turn enabling them to prepare a defense. *Goldsmith v. Technology Solutions Co.*, 1993 WL 150035 at *5 (N.D. Ill. 1993). The defendants contend that Kauthar fails to meet this standard in alleging control person liability because it lumps all of the defendants together, implying that each defendant is responsible for the acts of the other defendants. *See e.g., Sears v. Likens*, 912 F.2d 889, 893 (7th Cir. 1990).

Kauthar makes its allegations of control person liability in Paragraphs 106 and 118. The defendants point out that these paragraphs fail to reveal *whom* the Tongasat defendants are alleged to have controlled or *whether*, in fact, the Tongasat defendants are alleged to be control persons at all. For example paragraph 106 at 53-54 states:

> Hilliard, Nilson, both individually and on behalf of Tongasat, NRC, S. Hilliard, Tongasat, the Princess and Fletcher, Sternberg and Risser, individually, together, and as agents of each other, or some combination of the above Defendants, exercised control over Rimsat, Simon and Nilson for the reasons stated herein. Each of these Defendants had the power and influence to direct Rimsat, Simon and Nilson, and/or the other Defendants primarily liable, to make or not to make the misrepresentation and omissions alleged herein. Furthermore, Tongasat is liable for the acts of Nilson under the theory of respondeat superior.

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The defendants argue that it is apparent that Kauthar is not sure exactly who controlled whom; any of the named defendants, "or some combination" of them may or may not have controlled any of Rimsat, Simon and Nilson. The defendants claim that such equivocation prevents them from knowing with what they are charged, and, in turn, from preparing a defense. Thus, the defendants assert that Kauthar's claims of control person liability should be dismissed.

Kauthar, in brief two-paragraph response, merely asserts that "even the most cursory reading of Kauthar's Complaint provides a clear understanding of the allegations to which the Tongasat Defendants will be required to respond." This court has reviewed the complaint and agrees with the defendants that the allegations of control person liability fail to meet the standards of Rule 9(b).

The defendants also argue that, even if the Counts I and IV do not fail the particularity test, Kauthar's amended complaint stills fails to state a claim for control person liability. Under Seventh Circuit precedent, Kauthar must allege that the defendants (1) "actually exercised general control over the operations of the entity principally liable" and (2) "possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, even if such power was not exercised." *Donohoe v. Consolidated Operating & Prod. Corp.*, 982 F.2d 1130, 1138 (7th Cir. 1992), *on remand*, 883 F. Supp. 719 (N.D. Ill. 1993), *aff'd*, 30 F.3d 907 (7th Cir. 1994); *Harrison v. Dean Witter Reynolds, Inc.*, 974 F.2d 873, 880-81 (7th Cir. 1992).

With respect to the first part of the test, Kauthar merely alleges that Princess Pilolevu and Mr. Fletcher were,

respectively, Chair/Chief Executive Officer and Director of Tongasat. Amended Complaint ¶¶12 and 13 at 5-6. The defendants point out that merely reciting the positions occupied by the Tongasat defendants does not make them control persons of Nilson, as such a "control by status" theory has been repeatedly rejected. *See Koplin v. Labe Federal Sav. and Loan*, 748 F. Supp. 1336, 1341 (N.D. Ill. 1990), *Pershing*, 1989 WL 165155, n. 6 at *8.

The defendants also argue that the amended complaint fails to allege that the defendants exercised *actual control* over any allegedly liable entity. *Donohoe*, 982 F.2d at 1138; *Harrison*, 974 F.2d at 880-81. The defendants claim that Kauthar has merely laden its amended complaint with accounts of how defendant Nilson was involved with the affairs of Rimsat "on behalf of" Tongasat. The defendants claim that Kauthar's "boilerplate assertions" fail to transform the Tongasat defendants into "control persons" because Kauthar cannot show that the Tongasat defendants were, in fact, control persons of Nilson.

Again, Kauthar responds by merely asserting that its complaint is sufficient. Kauthar also disputes that it must allege *actual control*. In *Harrison*, the decision cited by both sides, the Seventh Circuit stated:

> We have long viewed the statute as remedial, to be construed liberally, and " 'requiring only some indirect means of discipline or influence short of actual direction to hold a "control person" liable.' " (citations omitted). . . . We have looked to whether the alleged control-person actually participated in, that is, exercised control over, the operations of the

> person in general and, then, to whether the alleged control-person possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, whether or not that power was exercised.

Kauthar has not shown how the allegations in its complaint meet the first part of this standard. Kauthar claims that since the defendants have admitted that they terminated Nilson, the defendants clearly had "actual" power over Nilson and thus "actual control". Kauthar has not provided the court with any authority to support its position that the power to terminate a person equates with "actual control" for purposes of the securities statutes. The Harrison decision itself states that the test is whether the alleged controlling person "exercised control over, the operations of the person in general". Kauthar has not even argued that it has alleged that the defendants exercised control over the operations of Nilson.

The defendants next assert that Kauthar has failed to meet the second prong of the control definition, as Kauthar has failed to proffer any facts supporting the assertion that the Tongasat defendants "had the power and influence to direct Rimsat, Simon ad Nilson, and/or other Defendants primarily liable, to make or not to make the misrepresentations and omissions alleged herein." Amended Complaint ¶118 at 57. *Donohoe*, 982 F.2d at 1138; Harrison, 974 F.2d at 880-81. Again, Kauthar has simply referred the court to various paragraphs of its complaint, and asserts that these paragraphs adequately set forth the requisite facts. Kauthar has not attempted to explain to the court how its amended complaint meets the second part of the test set forth in Harrison. This court has reviewed Kauthar's amended complaint and fails to find sufficient factual

allegations showing how the defendants could have had the power or ability to participate in the drafting, review or distribution of Rimsat's private placement materials or the alleged "omissions" and "misrepresentations". *Harrison*, 974 F.2d at 879-880.

Accordingly, this court finds that Kauthar has failed to state a claim for control person liability under either the 1933 or 1934 Acts and, consequently, Counts I and IV will be dismissed.

The defendants next assert that the RICO allegations in Counts IX through XIV fail to state a claim upon which relief can be granted. Kauthar asserts six different causes of action against the various defendants under the RICO (Racketeer Influenced Corrupt Organizations) statute, 18 U.S.C §§ 1962(a)-(d)[7].

RICO is aimed at eradicating long-term criminal activity that poses some threat to society. *Midwest Grinding Company, Inc. v. Spitz*, 976 F.2d 1016, 1025 (7th Cir. 1992); *see also Sedima, S.P.R..L. v. Imrex Co.*, 473 U.S. 479 (1985)(RICO's principal target is the economic power of racketeers, and its toll on legitimate businessmen). The defendants argue that Kauthar's complaint fails to support a claim that they engaged in *any* criminal activity, let alone any long-term criminal activity that might subject it to civil RICO liability

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7. Count IX alleges that the defendants invested income derived from a patten of racketeering activity to establish and operate Rimsat, §1962(a). Count X alleges that the defendants acquired and maintained their interest in Rimsat through a pattern of racketeering activity, §1962(b). Count XI alleges that the defendants conducted the affairs of Rimsat through a pattern of racketeering activity, §1962(c). Counts XII, XIII and XIV allege that the defendants conspired to violated §§1962(a), (b) & (c), §1962(d).

First, the defendants argue that Kauthar has failed to adequately plead that they committed the requisite predicate acts. A pattern of racketeering activity, consisting of at least two predicate acts, is an essential element of every RICO claim. 18 U.S.C. § 1962. As predicate acts for each of its RICO claims, Kauthar alleges that the defendants engaged in securities, mail and wire fraud, and in violations of certain Indiana criminal statutes. Count IX ¶ 109 at 79: Count IX ¶112 at 89; Count X1 ¶111 at 91; Count XII ¶114 at 93; Count XIII ¶114 at 95; Count XIV ¶113 at 97. The defendants contend that Counts IX through XIV should be dismissed because Kauthar has not alleged facts tending to show that the defendants committed any predicate acts as the alleged state law violations do not constitute racketeering activity under 18 U.S.C. §1961 and, moreover, Kauthar has failed to allege securities, mail fraud and wire fraud with the requisite particularity.

The defendants argue that the alleged violations of state law do not constitute racketeering activity. Specifically, the defendants point out that the state law offenses that qualify as predicate acts include only:

> any act or threat involving murder, kidnaping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year[.] (18 U.S.C. § 1961(1)(A)]

The state laws cited by Kauthar as predicate acts prohibit criminal mischief, IC § 35-43-1-2 (a) (2) (Count XVIII); theft and receipt of stolen property, IC §35-43-4-2 (Count XIX); criminal conversion, IC § 35-43-4-3 (Count XX); deception,

IC §§ 35-43-5-3(a)(2), (a)(3), (a)(6) and (a)(9) (Count XXI); and fraud, IC § 35-43-5-4 (8) (Count XXII).[8] The defendants argue that none of these offenses involves murder, kidnaping, gambling, arson, robbery, bribery, extortion, or drug dealing, the only state crimes that § 1961 (1) (A) defines as racketeering acts. The defendants further argue that criminal conversion and deception are punishable by prison terms of less than one year[9], and therefore do not qualify under 18 U.S.C. §1961(l)(A)'s additional requirement that state crimes alleged as predicate acts must be punishable by imprisonment for more than one year.

Thus, the defendants conclude that because the alleged violations of Indiana law are not racketeering acts, Kauthar has failed to state an essential element of a RICO violation. *Jennings v. Emry*, 910 F.2d 1434, 1438 (7th Cir. 1990)(RICO claims based on alleged violation of Indiana criminal mischief and other state laws dismissed because such state offenses are not racketeering acts); *see also Manion v Freund*, 967 F.2d 1183 (8th Cir. 1992) (RICO claims asserting state law violations as predicate acts dismissed where offenses did not meet statutory definition of racketeering activity).

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8. Counts X, XI and XIV of the Amended Complaint assert all of these alleged state law violations as predicate acts. Count X ¶112 at 89; Count XI ¶111 at 91; Count XIV ¶13 at 97. Counts IX, XII and XIII omit criminal conversion and deception from the list of predicate acts. Count IX ¶¶109 at 79; Count XII ¶114 at 93: Count XIII ¶114 at 95.

9. Both criminal offenses are Class A misdemeanors. That is, both IC §§ 35-43-4-3 and 35-43-5-3(a) are punishable by imprisonment for "not more than one year." IC § 35-50-3-2.

In response, Kauthar argues that the state law offenses designated as predicate acts in §1961(l)(A) are included by generic description and this court only need to determine "whether the indictment charges a type of activity generally known or characterized in the proscribed category." *United States v. Forsythe*, 560 F.2d 1127, 1137 (3d Cir. 1977). Kauthar further points out that the legislative history to RICO indicates that "[s]tate offenses are included by generic designation." H.R. Rep. No. 1549, 91st Cong., 2d Sess. 56 (1970), reprinted in 1970 U.S. Code Cong. & Admin. News 4007, 4032.

Kauthar has directed the court to what it terms "the generic definition of robbery" as set forth in *Black's Law Dictionary:*

> A person is guilty of robbery if, in the course of committing a theft, he: (a) inflicts serious bodily injury upon another; or (b) threatens another with or purposely puts him in fear of immediate serious bodily injury; or (c) commits or threatens immediately to commit any felony of the first or second degree. An act shall be deemed in the course of committing a theft if it occurs in an attempt to commit theft or in flight after the attempt or commission. Model Penal Code, §221.1

Black's Law Dictionary at p. 1193 (5th ed. 1979).

Kauthar points out that in its complaint, it has pled that in the course of committing one felony, for example, "theft/receipt of stolen property", the identified defendants committed numerous acts of criminal mischief, fraud, mail fraud, wire fraud, bribery, extortion, and one act of bankruptcy fraud. Additionally, Kauthar claims that in the course of committing

unlawful criminal mischief and fraud and theft the identified defendants committed other felonies. Thus, Kauthar concludes that it has pled, and will likely be able to prove at trial, that the identified defendants committed state law criminal offenses equivalent to a generic "robbery."[10]

Kauthar has not provided the court with any authority supporting its position that the state law definition of robbery is irrelevant, and that the dictionary definition of robbery is controlling in defining predicate acts. Kauthar's reliance on *United States v. Forsythe,* 560 F. 2d 1127 (3d Cir. 1977), is completely misplaced. In *Forsythe,* the issue was whether the classification of criminal prohibitions determined whether the prohibition constituted a predicate act. The Third Circuit held that the Pennsylvania offenses of common law bribery and corrupt solicitation fit within the generic category of bribery (as defined by Pennsylvania state law), and carried prison terms in excess of one year, and thus constituted predicate acts. The Third Circuit did not resort to a dictionary definition of bribery, nor did it ignore the elements of the crime as set forth in Pennsylvania law.

It is abundantly clear that the Indiana state law violations Kauthar alleges that the defendants committed do not constitute racketeering activity. Kauthar has erroneously stated that criminal mischief, theft and receipt of stolen property, and fraud

10. Additionally, Kauthar claims that the facts as alleged in the amended complaint indicate that the commission of the state statutory law violations (Counts XVIII, XIX & XXII) may also constitute the generic equivalents of bribery and extortion, which are also predicate acts under RICO. The defendants have objected to this claim, and point out that Kauthar has not made such a claim in its amended complaint. As Kauthar has not alleged bribery or extortion as a predicate act, the court will not consider these claims.

are "equivalent to a generic 'robbery' ". As the amended complaint does not allege facts stating the essential elements of the crime of robbery under Indiana law, which include the use or threat of force against a person or otherwise putting a person in fear[11], Kauthar has failed to plead the necessary predicate act. *Jennings v. Emry*, 910 F.2d 1434, 1438 (7th Cir. 1990); *Manion v. Freund*, 967 F.2d 1183 (8th Cir. 1992); *Greek-Radio Network of America, Inc. v. Vlasopoulos* 731 F. Supp. 1227 (E.D. Pa. 1990).

The defendants next argue that Kauthar has failed to state any claim for securities fraud against the defendants and, thus, Kauthar cannot rely on the alleged securities fraud as predicate acts for the RICO counts. *Coronet Insurance Co. v. Seyfarth*, 665 F. Supp. 661 (N.D. Ill. 1987). As this court has previously dismissed Kauthar's claims based on securities fraud, the defendants are correct in their assertion that these claims may not be used as predicate acts.

The defendants next assert that Kauthar has failed to state a claim for mail or wire fraud against the defendants because it has not alleged such fraud with the specificity necessary to satisfy Fed. R. Civ. P. 9(b).

Allegations of mail and wire fraud must be supported by facts tending to show (1) the existence of a scheme to defraud, (2) defendant's knowing or intentional participation in that scheme and (3) use of the mails or wire communications in

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11. IC §35-42-5-1 sets forth the following elements for the crime of robbery: "A person who knowingly or intentionally takes property from another person or from the presence of another person: (1) by using or threatening the use of force on any person: or (2) by putting any person in fear; commits robbery, a Class C felony.

furtherance of the scheme. 18 U.S.C. §§ 1341, 1343. The defendants point out that Kauthar has alleged only one fraudulent scheme, that is, the putative scheme to induce Kauthar to invest in Rimsat. The defendants claim that Kauthar's amended complaint does not contain any factual allegations tending to show the defendant's participation in that scheme or its use of the mails or wire communications in furtherance thereof.

Kauthar has alleged that:

> Defendants . . . have utilized the United States mails and wires in violation of 18 U.S.C. § 1341 and 18 U.S.C. § 1343 as follows:
>
> (a) Conversations by telephone and by United States and international mails between Tongasat and Nilson in San Diego, California and the ITU and IFRB in Geneva, Switzerland, beginning as early as 1987 and continuing periodically, at least monthly, to obtain for Tonga on approximately June 24, 1991, rights in the seven (7) GSO positions on the grounds that these slots would be used to satisfy the desperate telecommunications needs of Tonga and that there was no intent to "traffic" or "stockpile" in orbital positions, which in fact was false. . . .
>
> (b) Conversations by telephone between Simon, Sternberg, Hilliard, Nilson and Risser from Fort Wayne, Indiana and San Diego, California, and Kauthar beginning in March 1992, to negotiate the sale of Class "C" shares to Kauthar;

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(r) The payment to Nilson, the Princess, Fletcher and Tongasat of expenses, compensation and bonuses by means of international wire transfers from Rimsat's Fort Wayne, Indiana bank accounts during the period June 3, 1993, to at least May 24, 1994 totaling over $227,000;

(u) Upon information and belief, in furthermore of the scheme to defraud Kauthar, monies were wire transferred from Rimsat's Fort Wayne, Indiana bank to banks in Russia, Tonga, California, Arizona and the Philippines to further fund and finance the secret and unlawful dealings and operations between Simon, Sternberg, Hilliard, Nilson and Rimsat, on the one hand, and Rimsat Russia, RSCI, PTI, Tongasat, the Princess, Risser, Subic Bay and Via/Net, on the other hand as set forth herein. . . .

(w) By correspondence dated December 30, 1994, delivered by Pritchard of Tongasat to Mr. Lee Hok Chye, Kauthar's Malaysian attorney, by wire and United States and international mails, from Fort Wayne, Indiana, to Malaysia, Pritchard threatened that:

> "Any upheaval involving a Tongasat licensee [Rimsat) will inevitably impair the reputation some, *and give critics of competitors reasons for saying that we are trafficking in orbital positions. It was for these reasons that we delayed so long in calling the default,* and did so only after Mr. Simon was unable to comply even

> with the generous offer we made to him to amortize the indebtedness under favorable terms." (emphasis added)
>
> (x) In furtherance of the plan, Nilson prepared and sent to Kauthar by wire and United States and international mails, among other materials, several items of correspondence dated July 25, 1992, July 30, 1992, November 9, 1992, and February 13, 1993, on Tongasat stationery, concerning the proposed investments by Kauthar in Rimsat securities, which contained misrepresentations and omissions like those referred herein. [Amended Complaint Count IX at ¶109, at 79-80, 86-87.)

The defendants argue that Kauthar's allegations do not satisfy the requirements of Fed. R. Civ. P. 9(b), as set forth in the relevant case authorities. Specifically, the defendants argue that for each predicate act of mail or wire fraud, Kauthar fails to specify:

> the identity of the persons making the representations, the time, place and content of the misrepresentations and the method by which the misrepresentation was communicated to the plaintiff.

*Uni*Quality, Inc. v. Infotronx, Inc.*, 974 F.2d 918, 923 (7th Cir. 1992) (dismissing RICO claims for failure to "plead 'the who, what, where and when of the alleged fraud' "); *see also Design Time, Inc. v. Synthetic Technology, Inc.*, 674 F. Supp. 1564, 1571 (N.D. Ind. 1987)(dismissing RICO claims for failure to allege "what was said, to whom, by whom, when or where");

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Graue Mill Development Corp. v. Colonial Bank & Trust Co. of Chicago, 927 F.2d 988 (7th Cir. 1991)(dismissing RICO claims for failure to allege time and place of alleged misrepresentations and individuals party to the misrepesentations); *Midwest Grinding Co., Inc. v. Spitz,* 716 F. Supp. 1087 (N.D. Ill. 1989), *aff'd,* 976 F.2d 1016 (7th Cir. 1992)(failure to specify date and place of alleged predicate acts of fraud requires dismissal of RICO counts).

The defendants argue that Kauthar's vague allegations of telephone conversations, mailings and wire transfers fails to meet the above requirements. The defendants contend that the allegation with respect to communications with the ITU and IFRB fails to state the time, place or content of the misrepresentations or to whom the misrepresentations were made. Amended Complaint, Count IX ¶ 109(a) at 79-80. This allegation merely cites arguments made by Intelsat in opposition to Tonga's application for the GSO slots. *Id.* ¶ 34 at 13. Moreover, Kauthar has not alleged that Tonga obtained the slots as part of the scheme to defraud. And, in fact, Rimsat, the vehicle through which the alleged fraud was perpetrated, did not even come into existence until April 1992, five years after the communications with the ITU and IFRB are alleged to have commenced and at least one year after they are alleged to have ended. Count IX ¶42 at 15, ¶ 109(a) at 79-80. The defendants further claim that the allegation with respect to Dr. Pritchard's December 30, 1994 correspondence to Mr. Lee Hok Chye fails to identify any misrepresentation whatsoever. Count IX ¶ 109(w) at 86. Such allegations do not state a claim for fraud. *Veal v. First American Savings Bank,* 914 F. 2d 909 (7th Cir. 1990) (plaintiff alleging fraud must identify particular statements and actions and specify why they are fraudulent).

Additionally, the defendants claim that Kauthar's allegation with respect to Nilson's correspondence with Kauthar on Tongasat stationery also fails to identify the content of any misrepresentations, stating only that the correspondence "contained misrepresentations and omissions like those referred herein." Count IX ¶109(x)at 87. The mere assertion that misrepresentations were made does not comply with Rule 9(b)'s particularity standard. *Design Time,* 674 F. Supp. at 1571. The defendants assert that as the alleged recipient of the mailings described in ¶¶ 109(w) and 109(x) , Kauthar's failure to provide more specific information is inexcusable, as well as suspect.

Continuing, the defendants also assert that Kauthar's allegations with respect to the wire transfers are also deficient. Kauthar alleges in Count IX ¶109(r) that Tongasat received payments in the amount of $227,000 by means of international wire transfers from Rimsat's Fort Wayne, Indiana, bank accounts between June 3, 1993 and May 24, 1994. But Kauthar contradicts itself elsewhere when it alleges, "upon information and belief," that Rimsat wire transferred the $227,000 to PTI and/or Nilson, and "upon information and belief" some portion thereof was paid to the Princess and Fletcher. *Id.* ¶ 48 at 16. The defendants point out that this allegation not only omits any mention of funds going to Tongasat, but also states that the wire transfers were made "through PTI and/or Nilson' rather than directly to the Princess or Fletcher, as ¶109(r) requires.

In ¶¶73-74, at 23, Kauthar again recharacterizes the same transactions. Kauthar states that, in April 1993, "certain officers of Rimsat" entered into an agreement to make payments to PTI ("a company owned and controlled by Nilson, and upon information and belief, Fletcher and the Princess") from Rimsat funds and that "Rimsat, Simon, Sternberg and others paid PTI

and, therefore Nilson, Fletcher and the Princess" the $227,000. The defendants contend that these paragraphs not only fail to assert that any of the funds went to Tongasat, but also expand the list of payors and omit any reference to the payments being made "through PTI and/or Nilson" as contended in ¶48. Finally, in ¶100(g) at 50, Kauthar states that "Tongasat, the Princess and Fletcher had received, and were to receive in the future, payments from Rimsat' totaling $227,000 "paid to an entity called 'PTI,' which, upon information and belief, was owned or controlled by Nilson, Hilliard, the Princess and Fletcher." Inexplicably, state the defendants, this paragraph includes Tongasat for the first time as a recipient of payments from PTI and also adds Hilliard to the list of individuals that allegedly owned or controlled PTI.

The defendants argue that these inconsistent allegations are fatal to Kauthar's ¶109(r) wire fraud claim against the defendants and underscore the importance of Rule 9(b)'s particularity requirements. The defendants state that Kauthar has been unable to keep its story straight, thus preventing the defendants from defending against Kauthar's claims. "Allegations made upon information and belief are insufficient, even if the facts are inacessible to the plaintiff, unless the plaintiff states the grounds for his suspicions." *Uni*Quality*, Inc., 974 F.2d at 924. The defendants argue that Kauthar has adduced no basis for its speculation that the defendants received any of the $227,000 through wire transfers or otherwise. The defendants contend that the only grounds articulated for Kauthar's suspicion that any entity other than PTI received the funds is another allegation, "upon information and belief," that PTI was owned and controlled by Princess Piloleveu, Mr. Fletcher, and Hilliard.

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The defendants next argue that Kauthar's final wire fraud claim against the defendants fails to allege any specifics, including dates, recipients or amounts, of the funds purportedly wire transferred "to banks in Russia, Tonga, California, Arizona and the Philippines." The defendants point out that this allegation also lacks specificity and is based "upon information and belief." Count IX ¶109(u) at 86. Furthermore, Kauthar has not articulated the grounds for its suspicions that wire fraud was perpetrated or, even if it was, that the specific defendants were in any way involved.

The heightened pleading standard of Rule 9(b) is designed to protect defendants from the harm caused by serious charges of wrongdoing and to give them adequate notice of the conduct of which they area accused. *Uni*Quality*, 927 F.2d at 924. Courts in the Seventh Circuit have consistently held that where, as here, there are multiple defendants, the complaint must inform *each* defendant of the *specific* fraudulent acts that constitute the basis of the action against each particular defendant.

A plaintiff "may not 'lump' defendants together in general allegations of fraudulent activity, implying that each defendant is responsible for the statements and actions of others." *Coronet Insurance Co. v. Seyfarth*, 665 F. Supp. 661, 666 (N.D. Ill. 1987) (allegations that the "Seyfarth group" or "defendants" made omissions or affirmative misrepresentations lacked particularity necessary to state claims for securities, mail or wire fraud as predicate acts under RICO); *Vicom, Inc. v. Harbridge Merchant Services, Inc.*, 20 F.3d 771, 778 (7th Cir. 1994)(affirming dismissal of RICO claims for failure to plead fraud against each defendant with specificity); *Sears v. Likens*, 912 F.2d 889 (7th Cir. 1990) (affirming dismissal of RICO complaint that

"lump[ed] all the defendants together and [did] not specify who was involved in what [fraudulent] activity"); *Beck v. Cantor Fitzgerald & Co.. Inc.*, 621 F. Supp. 1547 (N.D. Ill. 1985) (RICO claims based on securities, mail and wire fraud dismissed where plaintiff did not identify persons who made alleged misrepresentations or adequately distinguish among many defendants alleged to have participated in fraud); *Bruss Co. v. Allnet Communications Services, Inc.*, 606 F. Supp. 401, 405-06 (N.D. Ill. 1985)(RICO claim against individual defendants dismissed where complaint failed to specify how any individual defendant participated in fraud).

The defendants argue that Kauthar seeks to assert conclusory accusations of mail and wire fraud against the defendants individually without (1) identifying any misrepresentations made specifically by the individual defendants, (2) alleging that the specific defendants knowingly or intentionally participated in any scheme to defraud or (3) specifying any act by the specific defendants through which the fraud was, perpetrated. The defendants conclude that the amended complaint does not fairly notify them of the basis for Kauthar's accusation of fraud and, therefore, Kauthar's RICO counts should be dismissed for failure to allege involvement in any racketeering activity[12].

Kauthar, in response, has asserted that the amended complaint identifies the "actual acts of wire and mail fraud themselves by date, author and recipient, description of substance, method of delivery and . . . how the communication

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12. Kauthar does not allege that Tongasat participated in the bankruptcy fraud which it relies upon, in Count IX ¶111 at 87, as a predicate act in its RICO claims against defendant James A. Simon.

furthered" the scheme to defraud[13]. However, as the defendants point out, Kauthar has mischaracterized its amended complaint. For example in paragraph 109(a) at 79-80, where the only details given are that telephone calls and mailings were made by Nilson and Tongasat to the ITU/IFRB between 1987 and 1991 and ¶ 109(u) at 86, where the only details given are that monies were wire transferred from Rimsat's Fort Wayne, Indiana bank to unidentified banks all over the world. Such vague allegations do not comply with Rule 9(b). *Fujisawa Pharmaceutical Co. Ltd. v. Kapor,* 814 F. Supp. 720 (N.D. Ill. 1993)(RICO claims based on loose references to mailings and telephone calls dismissed for failure to comply with Rule 9(b)).

Kauthar has further argued that the communications supporting acts of mail or wire fraud need not contain omissions or misrepresentations[14]. As the defendants point out, this argument ignores the fact that the amended complaint specifically alleges that the written communications attributable to the Tongasat defendants did "contai[n) misrepresentations and omission" but does not provide any details other than that they are "like those referenced herein.[15]" The Seventh Circuit has held repeatedly that where wire and mail fraud are alleged as predicate acts, 'the complaint must, at a minimum, describe the predicate acts with some specificity and 'state the time, place and content of the alleged communications perpetrating the fraud.' " *Midwest Grinding Co., Inc. v. Spitz*, 976 F.2d 1016,

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13. Opposition at 87.

14. Opposition at 87-88.

15. Amended Complaint, Count IX, ¶109(x), at 87.

1020 (7th Cir. 1992) (citing *Graue Mill Development Corp. v. Colonial Bank & Trust Co.*, 927 F.2d 988, 992 (7th Cir. 1991)).

The defendants next assert that Kauthar has failed to allege a pattern of racketeering activity. The existence of a pattern of racketeering activity is a necessary element of each RICO claim. *H.J. Inc. v. Northwestern Bell Telephone Co.*, 492 U.S. 229 (1989). A pattern of racketeering activity requires a minimum of two predicate acts of racketeering within a ten year period. 18 U.S.C. §1961(5). Because the statute is directed at long term criminal conduct, merely alleging two predicate acts is not sufficient, in and of itself, to establish a pattern. Instead, a plaintiff "must show that the racketeering predicates are related and that they amount to or pose a threat of continued criminal activity." *H.J. Inc., supra,* 492 U.S. at 239. Continuity "is both a closed- and open-ended concept, referring either to a closed period of repeated conduct, or to past conduct that by its nature projects into the future with a threat of repetition." *Id.* at 241. The defendants argue that Kauthar has not alleged continuity under either concept.

In analyzing whether closed-ended continuity exists, courts in the Seventh Circuit consider:

> the number and variety of predicate acts and the length of time over which they were committed, the number of victims, the presence of separate schemes and the occurrence of distinct injuries.

Vicom, Inc., 20 F.3d at 780, quoting *Morgan v. Bank of Waukegan*, 804 F.2d 970, 975 (7th Cir. 1986). With respect to the first factor, the defendants claim that Kauthar has not alleged a variety of predicate acts occurring over a substantial period

of time. That is, the defendants contend that the alleged securities, mail and wire fraud are based on the same underlying misrepresentations an omissions, and all relate to Kauthar's purchase of Rimsat stock. The defendants point out that Kauthar even acknowledges that the alleged solicitation lasted only four months, beginning in "late December 1992, or early 1993" when it received the "written prospectus/business plan" containing the alleged misrepresentations and omissions, and continued until April 12, 1993 when it signed the subscription agreement. Amended Complaint ¶91 at 28, ¶102 at 52. The defendants state that Kauthar has attempted to stretch the duration of the alleged mail fraud from 1987 through December 1994 by reference to Nilson's correspondence with the ITU and IFRB and to Dr. Pritchard's December 30, 1994 letter to Kauthar's attorney. *Id.* Count IX ¶¶109(a) & (w) at 79, 86. The defendants have pointed out, however, that Kauthar identifies no misrepresentations in this correspondence. In *R.E. Davis Chemical Corp. v. Malco Chemical Co.*, 757 F. Supp. 1499 (N.D.Ill. 1990), the court confirmed that such vague allegations will not support a RICO claim. A plaintiff who bases a RICO claim on acts of mail and wire fraud "must do more than outline a scheme and make loose references to mailings and telephone calls; rather, the plaintiff must be careful to allege such particulars as . . . how the communication furthered the scheme to defraud." *Id.* at 1516.

The Seventh Circuit has repeatedly stressed its disapproval of the practice of relying on many instances of mail or wire fraud to establish a pattern of racketeering activity:

> Mail fraud and wire fraud are perhaps unique among the various sorts of "racketeering activity" possible under RICO in that existence of a multiplicity of predicate acts . . . may be no indication of the

> requisite continuity of the underlying fraudulent activity. Thus, a multiplicity of mailings does not necessarily translate directly into a "pattern" of racketeering activity.

Vicom, Inc., supra, 20 F.3d at 781 (quoting *Lipin Enterprises, Inc. v. Lee*, 803 F.2d 322, 325 (7th Cir. 1986)); *United States Textiles, Inc. v. Anheuser-Busch Companies*, 911 F.2d 1261, 1268 (7th Cir. 1990); *Sutherland v. O'Malley*, 882 F.2d 1196, 1205 (7th Cir. 1989).

The defendants further assert that each of the allegations of mail and wire fraud relates back to the alleged securities fraud, which was concluded when Kauthar signed the subscription agreement on April 12, 1993. Amended Complaint ¶102 at 52. Thus, the defendants conclude that, at most, Kauthar alleges a short-term, closed-ended fraud, which courts in the Seventh Circuit have consistently held not to constitute a pattern. *Talbot v. Robert Matthews Distributing Co.*, 961 F.2d 654, 663 (7th Cir. 1992)(no pattern where multiple acts of mail fraud in furtherance of single scheme extended over several years); *United States Textiles*, 911 F.2d at 1268 (multiple acts of mail fraud over 16 months in furtherance of a single scheme did not establish pattern); *Triad Ass'n. Inc. v. Chicago Housing Authority*, 892 F.2d 583, 595 (7th Cir. 1989) (repeated acts of mail and wire fraud over 27 months in furtherance of a single scheme did not establish pattern); *Koulouris v. Estate of Chalmers*, 790 F. Supp. 1372 (N.D. Ill. 1992)(no pattern where predicate acts in furtherance of single scheme took place over 21 months).

In *United States Textiles. Inc., supra*, 911 F.2d at 1268, the Seventh Circuit Court of Appeals cited with approval an

observation by the Third Circuit in *Marshall-Silver Construction Co., Inc. v. Mendel,* 894 F. 2d 593, 597 (3d Cir. 1990):

> Virtually every garden-variety fraud is accomplished through a series of wire or mail fraud acts that are "related' by purpose and spread over a period of at least several months. Where such a fraudulent scheme inflicts or threatens only a single injury, we continue to doubt that Congress intended to make the availability of treble damages and augmented criminal sanctions dependent solely on whether the fraudulent scheme is well enough conceived to enjoy prompt success or requires pursuit for an extended period of time. Given its "natural and common sense approach to RICO's pattern element," we think it unlikely that Congress intended RICO to apply in the absence of a more significant societal threat.

The defendants further contend that Kauthar has alleged only one victim (itself)[16], one scheme (to induce plaintiff to

16. The defendants point out that the amended complaint alludes to "one or more schemes to defraud Kauthar, and certain other individuals" and "one or more common schemes to defraud." Count X ¶111 at 89; Count XI ¶111 at 91. It also asserts, "upon information and belief," that other individuals acquired stock in Rimsat in reliance upon the same offering materials distributed to Kauthar and that the materials were widely disseminated to "hundreds of members of the public." *Id.*, ¶89 at 27, ¶91 at 28. The amended complaint does not describe more than one scheme and does not identify any victims other than Kauthar. This court agrees with the defendants that Kauthar's unparticularized reference to "certain other individuals" and its allegation of reliance

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invest in Rimsat)[17] and one injury (loss of its investment). According to Seventh Circuit authority, a one-scheme, one-victim, one-injury, closed-ended fraud scenario does not constitute the type of long-term criminal conduct that RICO is intended to reach. *See e.g., Midwest Grinding, supra,* (continuity does not exist where there is one victim, one scheme and one type of injury); *J.D. Marshall Int'l, Inc. v. Redstart, Inc.*, 935 F.2d 815 (7th Cir. 1991) (continuity not established where plaintiff alleged one scheme, one victim and one transaction); *Hartz v. Friedman,* 919 F.2d 469 (7th Cir. 1990) (no continuity where complaint alleged two schemes, one victim and one injury); *Triad Ass'n, supra* (no continuity where complaint alleged one scheme, two transactions, one victim and one type of injury); *Sutherland v. O'Malley*, 882 F.2d 196 (7th Cir. 1989) (continuity not demonstrated where there was one scheme, one victim and one injury).

The defendants next assert that the amended complaint also fails to allege open-ended continuity, which may be demonstrated by showing that the predicate acts involve a specific threat of repetition indefinitely into the future or that the predicate acts are a regular way of conducting an ongoing RICO enterprise. *H.J., Inc. supra,* 492 U.S. at 242-243. The

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based upon "information and belief" are insufficient to support a pattern allegation. *Uni*Quality, supra,* 974 F.2d at 922-924 (plaintiff cannot establish existence of pattern of racketeering activity with unparticularized allegations of fraud against third parties).

17. The one scheme alleged in the amended complaint was "to obtain equity funding from Kauthar by means of false and deceptive statements of fact and omission of material facts." Amended Complaint ¶ 60 at 19-20.

defendants acknowledge that in each RICO count, Kauthar states:

> Defendants' pattern of racketeering activity is not isolated activity but, instead, constitutes Defendants' regular way of conducting the business of the criminal enterprise and there is a serious threat of such continued criminal activity.

Amended Complaint, Count X ¶113 at 94; Count XI ¶112 at 95; Count XII ¶117 at 97; Count XIII ¶ 117 at 99; Count XIV ¶116 at 101. However, the defendants assert that Kauthar has not supported its conclusory assertions with any supporting factual allegations, and that the assertions fail to demonstrate the continuity necessary to survive a motion to dismiss. *Vicom, Inc., supra,* 20 F.3d at 783 ("a threat of continuity cannot be found from bald assertions such as '[defendant] continues his racketeering activities' "); *Koulouris, supra,* 790 F. Supp. at 1377 (establishing that defendant "committed securities fraud as a regular way of conducting ongoing business requires more than allegations concerning the circumstances surrounding [plaintiff's] dealings with [defendant]").

Finally the defendants point out that Rimsat, the alleged criminal enterprise," is now in bankruptcy. Amended Complaint, Count IX ¶¶ 110-111 at 87. Therefore any possibility of another allegedly fraudulent scheme to induce plaintiff or others to invest in Rimsat has ended. *See Harris Trust & Savings Bank v. Salomon Bros.*, 813 F. Supp. 1341, 1345 (N.D. Ill. 1992)(no threat of future harm where fraudulent investment scheme "ended, as it had to, with [investment vehicle's] declaration of bankruptcy").

Appendix E

In response to the defendants' arguments with respect to the "pattern of racketeering activity" requirement, Kauthar asserts that it has met the requirement by alleging four separate schemes, over 100 predicate acts spanning eight years, an "impressive" variety of predicate acts, "several" distinct injuries and at least 100 victims of the fraudulent schemes.

In reply, the defendants again point out that the amended complaint alleges one, and only one, fraudulent scheme — the purported scheme to induce the purchase of equity interests in Rimsat. The defendants claim that Kauthar has not adequately alleged the existence of any additional schemes to defraud (1) the ITU and IFRB into assigning Tongasat satellite rights; (2) unidentified Class C shareholders into investing in Rimsat; or (3) Kauthar into investing additional monies (beyond the $38 million) in Rimsat.

This court agrees with the defendants on this point. Kauthar's allegations with respect to conversations with the ITU and IFRB do not identify the time, place or content of any misrepresentations nor to whom any misrepresentations were made, but are based instead on arguments made by a Tongasat competitor in opposition to Tongasat's application for the satellite slots. Such pleading does not meet the particularity standards of Rule 9(b). *Design Time, Inc. v. Synthetic Diamond Technology, Inc.*, 674 F. Supp. 1564, 1571 (N.D. Ind. 1987)(fraud allegations that do not specify "what was said, to whom, by whom, when or where" dismissed for failure to comply with Rule 9(b)).

Rather than state the existence of a separate scheme to defraud the Class C shareholders, the Amended Complaint specifically states only that "[u]pon information and belief,

those individuals who acquired the Class C shares after August 30, 1992 did so in reliance upon offering materials substantially the same in form . . . to that through which Kauthar acquired all of its interests." Amended Complaint ¶¶ 87-89, at 27. The Amended Complaint makes no specific allegations of fraud with respect to the sale of Class C stock before August 30, 1992. Moreover, the Amended Complaint states that the offering material — i.e., the Prospectus — was not "prepared" until late December 1992 or early 1993 (Amended Complaint, ¶91 at 28). Only thirteen Class C shares were issued after January 6, 1993. *Id.* ¶ 87(e). And, because the alleged scheme to induce Kauthar to invest additional funds was unsuccessful, it can claim no RICO injury. RICO provides a remedy only for persons who have been injured. 18 U.S.C. § 1964.

With respect to the myriad allegations of predicate acts, including state law violations, bribery, extortion, bankruptcy fraud, securities fraud and mail and wire fraud, Kauthar also misses the mark. As discussed previously, Kauthar cannot rely on the alleged state law violations because they do not constitute racketeering activity. Additionally, Kauthar cannot bolster its list of predicate acts with bribery or extortion because the Amended Complaint makes no such claims. *PMF Services, Inc. v. Grady*, 681 F. Supp. 549, 557 (N.D. Ill. 1988). And the Complaint also completely fails to assert that Tongasat participated in the alleged bankruptcy fraud.

Additionally, the securities and mail and wire fraud claims all relate to Kauthar's purchase of Rimsat stock and are not of sufficient duration to establish a pattern. Reading the complaint in the light most favorable to Kauthar, the complaint merely alleges that the stock solicitation lasted only four months, beginning when Kauthar received the "written prospectus/

business plan" in late December 1992 or early 1993 and ending when it executed the subscription agreement on April 12, 1993. Amended Complaint ¶ 91, at 28; ¶102 at 52. Kauthar's reliance on multiple instances of alleged mail and wire fraud to extend the duration of the fraud is groundless, as Kauthar apparently recognizes because it does not even address the long line of Seventh Circuit cases admonishing that where a pattern is premised on acts of mail or wire fraud, the sheer volume of mailings is not dispositive nor does it extend the period of misconduct for purposes of the pattern analysis. *See e.g., Midwest Grinding Co.*, 976 F.2d at 1024-25; *A.I. Credit Corp. v. Hartford Computer Group, Inc.*, 847 F. Supp. 588 (N.D. Ill. 1993).

The cases Kauthar relies on do not support its position on this issue. In *420 East Ohio Ltd. v. Cocose*, 980 F.2d 1122 (7th Cir. 1992), the court dismissed RICO claims based on mail and wire fraud because a large number of mailings over a six month period does not constitute racketeering. *United States v. Stodola*, 953 F.2d 266 (7th Cir. 1992), and *United States v. Freeman*, 6 F.3d 586 (9th Cir. 1993), involved, not mail or wire fraud, but multiple violations of bribery statutes over a 20 month and 2 year period, respectively. The other cases which Kauthar relies on are distinguishable on the grounds that each predicate act caused a separate economic harm, a situation not present in the case at bar. *A.I. Credit Corp. v. Hartford Computer Group, Inc.*, 84 7 F. Supp. 588 (N.D. Ill. 1994) (f our fraudulently induced loans over thirteen months from four different lenders based on misstatements of financial condition of two different corporations each with distinct ownership and engaged in different businesses); *Fujisawa Pharmaceutical Corp. v. Kapor*, 814 F. Supp. 720 (N.D. Ill. 1993) (where plaintiff purchased large blocks of stock in separate transactions

over six year period based on misstatements in several different annual reports, each purchase inflicted separate economic injury); *Liquid Air Corp. v. Rogers*, 834 F.2d 1 1297 (7th Cir. 1987)(distinct economic injury caused by each of 19 false shipping orders that deprived plaintiff of its entitlement to rent or replacement value).

Kauthar has also alleged only one injury — the loss in value of its Rimsat investment. Kauthar claims separate injuries from its initial $300,000 investment in Class C stock and its subsequent investment of $38 million in Class D stock, but in the Amended Complaint Kauthar concedes that it surrendered its Class C shares for the Class D stock as part of it $38 million purchase. Amended Complaint ¶101 at 52. *See Design Time, Inc.*, 674 F. Supp. at 1575 (independent sales of notes and bonds were two steps in same transaction); *Vicom, Inc.*, 20 F.3d at 782 (losses on multiple cancelable or potentially cancelable leases did not constitute distinct injuries). Additionally, although Kauthar claims a separate injury stemming from the alleged diversion of Rimsat funds, that claim, to the extent it exists, belongs to Rimsat and not to Kauthar.

Finally, Kauthar's allegation that other purchasers of Rimsat stock were also victims of the alleged fraud is meritless. *Uni*Quality, Inc. v. Infotronx, Inc.*, 974 F.2d 918 (7th Cir. 1992)(unparticularized references to other victims cannot support RICO pattern allegation). Moreover, the other purchasers were allegedly victimized by the same misrepresentations made to Kauthar. Amended Complaint ¶¶ 87-89 at 27. A finding of continuity cannot be based on similar injuries inflicted on multiple victims by the same predicate acts. *Design Time, Inc.*, 674 F. Supp. at 1578; *Vicom. Inc., v. Harbridge Merchant Services, Inc.*, 20 F.3d 771, 781 (7th Cir. 1994).

Appendix E

The defendants next argue that Counts IX and X fail to state a claim under §§ 1962(a) and 1962(b). Section 1962(a) prohibits any person who received income from a pattern of racketeering activity from using any part of such income to acquire any interest in, or establish or operate any enterprise engaged in interstate or foreign commerce. Section 1962(b) prohibits acquiring or maintaining, through a pattern of racketeering activity, any interest in any enterprise engaged in interstate of foreign commerce.

The defendants contend that Kauthar has failed to allege any facts to support its claims that the defendants violated §§ 1962(a) and (b), but has merely parroted the statute. Counts IX and X state:

> Defendants received income, which was derived both directly and indirectly from their pattern of racketeering activity, and part of all of this income was invested in the establishment of the enterprise, causing damage to the business and property of Kauthar. [Count IX ¶113 at 88]
>
> Defendants acquired and maintained their interest in the enterprise through the aforementioned pattern of racketeering, causing damage to the business and property of Kauthar. [Count X ¶114 at 89]

Initially the defendants point out that Kauthar has failed to distinguish among Tongasat and the other defendants. Moreover, according to the Amended Complaint, all of the income derived from the alleged securities, mail and wire fraud went directly to Rimsat and was disbursed by Rimsat. *Id.* ¶ 88 at 27, ¶ 102 at 52; Count IX ¶ 109(r) at 85. Kauthar does not

allege that Tongasat received any income from the alleged racketeering activities or invested that income in the establishment of Rimsat. Thus, Tongasat concludes that it cannot be hold liable under § 1962(a). *R.E. Davis Chemical Corp. v. Nalco Chemical Co.*, 757 F. Supp. 1499, 1525 (N.D. Ill. 1990) (dismissing § 1962 claims where complaint contained only conclusory allegation that defendants received income from racketeering activity); *Beck v. Cantor Fitzgerald, supra*, 612 F. Supp. at 1563 (if plaintiff cannot "specify the predicate acts and conduct of [the] enterprise by each allegedly liable defendant with particularity, in separate counts, he has no business charging RICO violations").

In both the original and amended complaints, Kauthar alleged that one-half of Hilliard's Rimsat stock was *secretly* owned by *Nilson*. Original Complaint ¶ 39 at 11; Amended Complaint ¶45 at 16. The original complaint contained no allegation that Tongasat held any interest in Rimsat. After the Tongasat defendants pointed out in their original motion to dismiss that Kauthar had failed to allege that Tongasat held any interest in Rimsat, Kauthar changed all subsequent references to the secret stock interest to imply that it was owned by both Nilson *and* Tongasat. However, the Amended Complaint fails to allege that any of the Tongasat defendants approved, authorized or were even aware of Nilson's secret interest in Rimsat. Therefore, the defendants argue that there is no basis for Kauthar's characterization of this interest as being owned by Tongasat.

The defendants further contend that Kauthar's complaint fails to include factual support for the assertion that Tongasat "acquired and maintained an interest" in Rimsat through a pattern of racketeering activity in violation of § 1962(b).

According to the defendants, Kauthar has attempted to impute the ownership of the Rimsat shares Hilliard "secretly" held in trust for Nilson to Tongasat, but the Amended Complaint makes clear that those shares were acquired in April 1992 prior to any alleged racketeering activity attributed to Tongasat. *Id.* ¶ 42 at 15, ¶45 at 16, ¶48 at 17.

In response to the defendant's assertion that Count IX of the Amended Complaint fails to state a violation of § 1962(a) because it fails to allege facts showing that Tongasat received any income from the alleged racketeering activities or invested that income in the establishment of Rimsat, Kauthar maintains that "Tongasat secretly acquired 25% of the then outstanding equity securities in Rimsat in return for its agreement to continue to participate in criminal and other unlawful activities."[18]

Unfortunately for Kauthar, however, this assertion does not appear in the Amended Complaint. Rather, the Amended Complaint alleges that (1) Rimsat was incorporated in April 1992; (2) the pre-incorporation agreement provided that 50% of the stock was to be issued to Hilliard; (3) half of Hilliard's shares were owned secretly by Nilson; (4) Nilson's shares were attributable to Tongasat because of his position as Managing Director; and (5) the shares issued secretly to Nilson "were issued as promoters' shares and for nominal cash consideration." Amended Complaint, ¶¶ 42, 45-46, 48, at 15-17. As the defendants point out, because the shares that Hilliard allegedly secretly held for Tongasat were issued for cash consideration prior to the generation of any income from the alleged racketeering activity, the income from that racketeering activity could not have been used to purchase those shares.

18. Opposition at 97.

Kauthar has also attempted to support its § 1962(a) claim by contending that the Tongasat defendants were paid by Rimsat with funds invested by Kauthar in the enterprise.[19] Here the defendants point out that §1962(a) does not render the receipt of racketeering income illegal. Rather, the statute only prohibits a person who has received such income from using it to invest in or establish an enterprise. *Midwest Grinding Co., Inc. v. Spitz*, 716 F. Supp. 1087, 1090 (N.D. Ill. 1989). Thus, Kauthar has failed to state a claim that Tongasat invested racketeering income in Rimsat, as Kauthar has merely alleged that Rimsat funds were used to *pay* the Tongasat defendants.

Likewise, Count X does not state a violation of §1962(b) because it alleges no facts showing that Tongasat acquired or maintained an interest in Rimsat through a pattern of racketeering activity. The Amended Complaint clearly states that the only interest the Tongasat defendants are alleged to have acquired in Rimsat was acquired prior to, and independent of, any purported racketeering activity. Amended Complaint at ¶ 45.

The defendants additionally claim that Kauthar lacks standing to assert §1962(a) or (b) claims. Section 1964 provides a civil damage remedy only to a person "injured in his business or property *by reason of* a violation of Section 1962" 18 U.S.C. §1964(c)(emphasis added). The defendants contend that Kauthar lacks standing to assert the claims in Counts IX and X because it has failed to show that it sustained an injury proximately caused by the alleged violation of §§ 1962(a) and (b).

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19. Opposition at 98.

The defendants claim that, at most, Kauthar has alleged an injury caused by the predicate acts of securities, mail and wire fraud, rather than an injury caused by the use or investment of racketeering income or the acquisition of an interest in Rimsat. According to the defendants, Kauthar's conclusory allegations, which merely repeat the language of the statute, are insufficient to meet the proximate cause requirements of §1964(c). *Midwest Grinding Co. v. Spitz*, 716 F. Supp. at 1091-92 ("conclusory allegations which parrot each of the four parts of section 1962" do not satisfy the requirement that the plaintiff demonstrate injury by reason of the RICO violations).

The majority of the circuits have held that, in order to state a claim for violation of §1962(a), a plaintiff must allege facts tending to show that the use or investment of racketeering income proximately caused its injury. Injury caused by the predicate acts is not enough because §1962(a) does not prohibit these acts. *See Nuggett Hydroelectric, L.P. v. Pacific Gas & Elec. Co.*, 981 F.2d 429 (9th Cir. 1992), *cert. denied*, 113 S.Ct. 2336 (1993); *Kehr Packages, Inc. v. Fidelcor, Inc.* 926 F.2d 1406 (3d Cir.), *cert. denied*, 501 U.S. 1222 (1991); *Craighead v. E.F. Hutton & Co.*, 899 F.2d 485 (6th Cir. 1990); *Ouaknine v. MacFarlane*, 897 F.2d 75 (2d Cir. 1990); *Grider v. Texas Oil & Gas Corp.*, 868 F.2d 1147 (10th Cir.).

Although the Seventh Circuit has not yet addressed this issue[20], the district courts in the Seventh Circuit have followed the majority rule. *E.g., R.E. Davis Chemical Corp., supra*, 797 F. Supp. at 1524, (§1962(a) provides a remedy only for injury resulting from use or investment of racketeering income, not for harm resulting from racketeering activity itself); *Midwest Grinding Co.*, 716 F. Supp. at 1090-91 (same); *Palumbo v. I.M.*

20. *See Vicom, Inc., supra*, 20 F.3d at 778-79, n.8.

Simon & Co., 701 F. Supp. 1407, 1409-11 (N.D. Ill. 1988) (same); *P.M.F. Services, Inc., supra*, 681 F. Supp. at 556-57 (same); *see also Grove Fresh Distributors, Inc. v. Flavor Fresh Foods. Inc.*, 720 F. Supp. 714, 717 (N.D. Ill. 1989) (allegations of reinvestment of racketeering income back into racketeering enterprise insufficient to satisfy proximate cause requirement).

Likewise, a plaintiff seeking damages for a violation of §1962(b) must set forth specific facts tending to show that it has been injured by defendant's acquisition or control of the enterprise. *Midwest Grinding Co.*, 716 F. Supp. 1091-92. The defendants claim that Kauthar has failed to adequately allege injury by reason of the alleged violations of §§1962(a) and (b), and thus Counts IX and X of the amended complaint should be dismissed.

Kauthar has attempted to satisfy the pleading requirements of §§1962(a) and 1962(b) by asserting (1) that the defendants' holdings in Rimsat have substantially lessened the value of Rimsat securities, (2) that Nilson and Tongasat have not acted in Rimsat's best interests, and (3) that Rimsat funds have been diverted and improperly invested[21].

The defendants, however, point out that these claims (to the extent they exist) caused injury to and thus belong to Rimsat, not Kauthar. As a shareholder, Kauthar has no standing to assert the claims personally or directly. *Sears v. Likens*, 912 F.2d 889, 892 (7th Cir. 1990)(RICO claim is corporate asset; shareholders have no standing as individuals to bring action for diminution in stock value caused by alleged racketeering activity).

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21. Opposition at 99-100.

The defendants are correct. Accordingly, Counts IX and X of the amended complaint must be dismissed for failure to state a claim. *Fujisawa Pharmaceutical,* 814 F. Supp. at 734-35 (dismissing §§1962(a) and (b) claims where plaintiff showed no injury from use or investment of racketeering income or acquisition or control of enterprise through pattern of racketeering).

Count XI of the amended complaint alleges that the defendants violated 18 U.S.C. §1962(c). Section 1962(c) prohibits any person employed by or associated with an enterprise engaged in interstate or foreign commerce from conducting or participating in the conduct of the enterprise's affairs through a pattern of racketeering activity. The Supreme Court has held that a person cannot be liable under §1962(c) unless that person "participated in the operation or management of the enterprise itself." *Reves v. Ernst & Young*, 113 S.Ct. 1163, 1173 (1993).

The defendants asserts that Kauthar has failed to set forth any facts tending to show that Tongasat participated in the operation or management of Rimsat. That is, the amended complaint merely alleges that Nilson "participated in the day-to-day operations of Rimsat," and "directed certain activities and operations of Rimsat." Amended Complaint ¶5 at 3, ¶67 at 21. The defendants argues that Kauthar's attempt to hold Tongasat liable for any alleged acts of Nilson under a *respondent superior* theory is unavailing. *See* Amended Complaint ¶106 at 53-54.

The defendants point out that the Seventh Circuit has "reject[ed] the doctrine of *respondeat superior* in civil RICO cases." *D&S Auto Parts, Inc. v. Schwartz*, 838 F.2d 964, 968 (7th Cir. 1988). Thus, the defendants conclude that absent a

showing that Tongasat itself participated in the management or operation of Rimsat, there is no-basis for liability under §1962(c).

In response to the defendants' contentions, Kauthar argues that the "corrupt activity took place at the highest levels of Tongasat," that the Princess and Mr. Fletcher authorized Nilson's misrepresentations to the ITU and IFRB in obtaining the orbital slots for Tongasat, and that Tongasat made unlawful and unauthorized payments to Hilliard through Via/Net[22]. The defendants, however, point out that these allegations relate to the alleged activities of Tongasat, not Rimsat, and so are irrelevant to a claim of liability under §1962(c), because Tongasat is not the RICO enterprise, as Kauthar acknowledges in its Opposition at 102.

Kauthar also relies on Nilson's service on the Rimsat board, his 25% interest in Rimsatf and his "day to day operation of the technical side of Rimsat's business." *Id.* However, the documents in Attachment A to the Kauthar's opposition brief show that Nilson was neither a member of the Rimsat Board of Directors nor a Rimsat shareholder until after December 10, 1993 — long after Kauthar purchased its interest in Rimsat. Moreover, the amended complaint does not allege that "the technical side of Rimsat's business" was operated through a racketeering pattern.

Kauthar also asserts that the Princess and Mr. Fletcher authorized the diversion of Rimsat funds to them[23]. The

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22. Opposition at 102.

23. Opposition at 101.

amended complaint, however, alleges that Rimsat, Simon and Sternberg, and not the Princess and Fletcher, authorized the payments. Amended Complaint ¶74 at 23.

Finally, Kauthar contends that Tongasat authorized Nilson's solicitation of Kauthar's investment in Rimsat[24]. The defendants argue that this allegation is not equivalent to a claim that Tongasat participated in the conduct of Rimsat's affairs. *A-1 Credit Corp.*, 847 F. Supp. at 601-02 (allegations that brokers prepared false financial statements for an enterprise, knowingly transmitted false financial information to lenders, and arranged for plaintiffs to make loans to the enterprise did not show participation in operation or management of the enterprise for purposes of a §1962(c) claim).

The defendants next argue that Kauthar fails in Counts XII, XIII and XIV to allege a conspiracy pursuant to §1962(d). Kauthar alleges that "[i]n violation of 18 U.S.C. §1962(d), Defendants, and each of them conspired to violate" 18 U.S.C. §§1962(a), 1962(b) and 1962(c), respectively, and carried out the conspiracy through a pattern of racketeering activity. (Count XII ¶¶115-16 at 93; Count XIII ¶¶115-16 at 95; Count XIV ¶¶114-15 at 97). The defendants contend that Kauthar has adduced absolutely no facutal allegations in support of its conspiracy assertions.

In *Frymire v. Peat Marwick Mitchell & Co.*, 657 F. Supp. 889, 895-96 (N.D.Ill. 1987), the court articulated the requirements that must be met to properly plead a RICO conspiracy:

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24. Opposition at 101.

> Any plaintiff alleging conspiracy must identify the nature of the conspiracy and the defendant's role in it with some particularity. . . . Above all, since conspiracy rests on agreement, the plaintiff must allege with some particularity facts sufficient to show an agreement among the parties to inflict the alleged wrong. . . .
>
> Alleging a conspiracy to violate RICO requires particularity for what can best be described analytically as two agreements: one to a pattern of racketeering activity as defined by the statute and another to the statutorily proscribed conduct.

If either aspect of the agreement is absent, there is no basis for an allegation that a defendant violated §1962(d). *United States v. Neapolitan,* 791 F.2d 489, 499 (7th Cir. 1986).

The defendants argue that, at best, Kauthar has addressed only half of this equation. That is, the only purported agreement in which Tongasat is alleged to have participated is described in ¶60 of the amended complaint, at 19-20, where Kauthar asserts that Nilson, both individually and on behalf of Tongasat, met with Simon, Sternberg, Hilliard, S. Hilliard and Risser "to discuss and ultimately agree upon a plan to obtain equity funding from Kauthar by means of false and deceptive statements of fact and omission of material facts." The defendants contend that this unparticularized allegation, even if deemed, *arguendo,* to properly plead a conspiracy to defraud, does not satisfy the elements of a RICO conspiracy. *Otto v. Variable Annuity Insurance Co.*, 814 F.2d 1127, 1137 (7th Cir. 1986)(dismissing RICO conspiracy claim despite the fact that plaintiff properly alleged securities fraud conspiracy).

Appendix E

The defendants point out that the amended complaint does not allege that each defendant agreed with the other defendants to engage in the conduct prohibited by §§ 1962(a), (b) or (c) — *i.e.*, (1) to derive income from racketeering activity and invest it in an enterprise; (2) to acquire or maintain an interest in an enterprise through a pattern of racketeering activity; or (3) to conduct the affairs of an enterprise through a pattern of racketeering activity. Absent such an allegation, supported by adequately particularized facts, Kauthar's conspiracy counts must fail. That is, a complaint, such as this one, "which merely implies, with the conclusory allegation of conspiracy, that a defendant is responsible for someone else's fraudulent acts" does not plead a cognizable conspiracy. *Frymire, supra*, at 895; *see also, Schiffels v. Kemper Financial Services, Inc.*, 978 F.2d 344, 352 (7th Cir. 1992)(conclusory allegations of conspiracy insufficient to state a claim under §1962; plaintiff must allege facts from which each defendant's agreement to violate §1962 can be inferred); *Koulouris, supra*, 790 F. Supp. at 1378 (dismissing RICO count because conclusory statement of conspiracy alleged no facts supporting inference of agreement or indicating nature of conspiracy and each defendant's role in it).

In response, Kauthar has not directly addressed the defendants' arguments. Rather, Kauthar argues that it need not allege or prove that each defendant committed the predicate acts, only that each defendant was part of a RICO conspiracy that damaged Kauthar.[25] Thus, as the defendants point out, Kauthar has ignored the second requirement for pleading a RICO conspiracy:

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25. Opposition at 102.

Appendix E

> Alleging a conspiracy to violate RICO requires particularity for what can best be described analytically as two agreements: one to a pattern of racketeering activity as defined by statute and another to the statutorily proscribed conduct.

Frymire v. Peat Marwick Mitchell & Co., 657 F. Supp. 889, 895-96 (N.D. Ill. 1987). The defendants contend that even if the amended complaint adequately alleged that each defendant agreed to the predicate acts, the amended complaint fails to allege that each defendant conspired to engage in the conduct proscribed by the statute.

A review of the complaint reveals that the defendants are correct once again. Kauthar's amended complaint completely fails to allege that the defendants engaged in a conspiracy. Clearly, a plaintiff must allege facts from which each defendant's agreement to violate §1962 can be inferred. *Schiffels v. Kemper Financial Services, Inc.*, 978 F.2d 344, 352 (7th Cir. 1992). Consequently, Kauthar's conspiracy counts will be dismissed for failure to state a claim.

Conclusion

For all of the foregoing reasons, Counts I, III, IV, IX, X, XI, XII, XIII, and XIV of Kauthar's amended complaint are hereby DISMISSED.

Enter: April 14, 1997.

s/ William C. Lee
William C. Lee, Chief Judge
United States District Court

APPENDIX F — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF INDIANA, FORT WAYNE DIVISION FILED APRIL 14, 1997

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

CIVIL NO. 1:95cv199

KAUTHAR SDN BHD, a Malaysian corporation,

Plaintiff,

v.

MICHAEL S. STERNBERG, *et al.*,

Defendants.

ORDER

This matter is before the court on a motion for summary judgment filed by the defendants, Dr. Matt C. Nilson ("Nilson") and Nilson Research Corporation ("NRC"), and Carl B. Hilliard, Jr. and Sharon E. Hilliard (the "Hilliards"), in which defendants James A. Simon ("Simon") and Michael S. Sternberg ("Sternberg"), and Friendly Islands Satellite Communications, Ltd., d/b/a Tongasat ("Tongasat/Tonga"), Her Royal Highness Princess Salote Mafileo Pilolevu Tuita (the "Princess"), Jerry J. Fletcher ("Fletcher") and W.L. Pritchard & Co., Inc. ("WLP") have joined. The parties completed briefing the motions on December 11, 1996.

Appendix F

Summary Judgment

Summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). However, Rule 56(c) is not a requirement that the moving party negate his opponent's claim. *Fitzpatrick v. Catholic Bishop of Chicago,* 916 F.2d 1254, 1256 (7th Cir. 1990). Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery, against a party "who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and in which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). The standard for granting summary judgment mirrors the directed verdict standard under Rule 50(a), which requires the court to grant a directed verdict where there can be but one reasonable conclusion. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986). A scintilla of evidence in support of the non-moving party's position is not sufficient to successfully oppose summary judgment; "there must be evidence on which the jury could reasonably find for the plaintiff." *Id. In Re Matter of Wildman,* 859 F.2d 553, 557 (7th Cir. 1988); *Klein v. Ryan,* 847 F.2d 368, 374 (7th Cir. 1988); *Valentine v. Joliet Township High School District No. 204*, 802 F.2d 981, 986 (7th Cir. 1986). No genuine issue for trial exists "where the record as a whole could not lead a rational trier of fact to find for the nonmoving party." *Juarez v. Ameritech Mobile Communications, Inc.*, 957 F.2d 317, 322 (7th Cir. 1992)(quoting *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986)).

Appendix F

Initially, Rule 56 requires the moving party to inform the court of the basis for the motion, and to identify those portions of the "pleadings, depositions, answers to interrogatories, and admission on file, together with the affidavits, if any, which demonstrate the absence of a genuine issue of material fact, *Celotex*, 477 U.S. at 323. The non-moving party may oppose the motion with any of the evidentiary materials listed in Rule 56(c), but reliance on the pleadings alone is not sufficient to withstand summary judgment. *Goka v. Bobbitt*, 862 F.2d 646, 649 (7th Cir. 1988); *Guenin v. Sendra Corp.*, 700 F. Supp. 973, 974 (N.D. Ind. 1988); *Posey v. Skyline Corp.*, 702 F.2d 102, 105 (7th Cir.), *cert. denied*, 464 U.S. 960 (1983).

So that the district court may readily determine whether genuine issues of material fact exist, under Local Rule 56.1, the moving party is obligated to file with the court a "Statement of Material Facts" supported by appropriate citation to the record to which the moving party contends no genuine issues exist. In addition, the non-movant is obligated to file with the court a "Statement of Genuine Issues" supported by appropriate citation to the record outlining all material facts to which the nonmovant contends exist that must be litigated. *See, Waldridge v. American Hoechst Corp. et al.*, 24 F.3d 918 (7th Cir. 1994). In ruling on a summary judgment motion the court accepts as true the non-moving party's evidence, draws all legitimate inferences in favor of the non-moving party, and does not weigh the evidence or the credibility of witnesses. *Anderson*, 477 U.S. at 249-251, 106 S.Ct. at 2511. Furthermore, in determining the motion for summary judgment, the court will assume that the facts as claimed and supported by admissible evidence by the moving party are admitted to exist without controversy, except to the extent that such facts are controverted in the "Statement of Genuine Issues" filed in opposition to the motion. L.R. 56.1

Appendix F

Substantive law determines which facts are material; that is, which facts might affect the outcome of the suit under the governing law. *Anderson,* 477 U.S. at 248. Irrelevant or unnecessary facts do not preclude summary judgment even when they are in dispute. *Id.* The issue of fact must be genuine. Fed. R. Civ. P. 56(c), (e). To establish a genuine issue of fact, the non-moving party "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita,* 475 U.S. at 586; *First National Bank of Cicero v. Lewco Securities Corp.,* 860 F.2d 1407, 1411 (7th Cir. 1988). The non-moving party must come forward with specific facts showing that there is a genuine issue for trial. *Id.* A summary judgment determination is essentially an inquiry as to "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson,* 477 U.S. at 251-252. Finally, the court notes that, "[i]t is a gratuitous cruelty to parties and their witnesses to put them through the emotional ordeal of a trial when the outcome is foreordained" and in such cases summary judgment is appropriate. *Mason v. Continental Illinois Nat'l Bank,* 704 F.2d 361, 367 (7th Cir. 1983).

Discussion

On March 10, 1995, the plaintiff, Kauthar Sdn Bhd ("Kauthar") , filed its original complaint and, on September 28, 1995, Kauthar filed its first amended complaint. Kauthar has asserted various claims against the defendants, which Kauthar alleges arose out of its purchase of securities in Rimsat, Ltd. ("Rimsat"). Rinsat is a Nevis corporation with its principal place of business in Fort Wayne, Indiana, and is currently in Chapter 11 bankruptcy.

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In its complaint, Kauthar alleges that it was induced to enter into a $38 million transaction to purchase Rimsat stock by the defendants' misrepresentations. The purchase of the stock in question occurred on April 12, 1993, with the execution of a subscription agreement ("agreement") for the purchase of 1800 shares of Rimsat class D voting stock[1].

The defendants point out that the party identified as the buyer and who executed the agreement as the buyer was Tajudin bin Ramli, and not Kauthar. The subscription agreement provides, in relevant part, that:

> This agreement ("Agreement") is made and entered into this 12th day of April, 1993 by and between Rimsat, Ltd., a Nevis corporation ("Rimsat") and Tajudin Bin Ramli ("Buyer").
>
> * * *
>
> Buyer presently owns sixty (60) shares of non-voting Class C stock of Rimsat. Buyer wishes to exchange his Class C stock for Class D stock and to purchase all of the remaining Class D stock. After the exchange and purchase, Buyer will own all of the Class D stock. In order to accomplish this transaction the Parties have agreed as follows:
>
> (1) Buyer will purchase 1800 shares of Rimsat's Class D stock for thirty eight million, ninety five thousand and two hundred and thirty-eight U.S. dollars (US$38,095,238) and Buyer's Class C stock.

---

1. *See* Affidavit of Kathleen Woodward, Exhibit A.

> The sale and purchase of this stock shall occur on the date hereof (the "Closing") at Buyer's offices in Kuala Lumpur.
>
> (2) At the time of the Closing, Rimsat shall deliver to Buyer duly signed and executed certificates for all of Rimsat's Class D stock together with certified copies of Rimsat's articles, by-laws, resolutions, representations and warranties which show the authority of Rimsat to carry out this transaction.
>
> Buyer may designate himself, or one or more entities in which he has an interest, as the owner(s) of the Class D stock. In the event that one or more of such entities is a corporation or partnership, Buyer will supply Rimsat with certified copies of resolutions or other documents which will show the authority of such entity to purchase such stock.

As the defendants have noted, the agreement is signed by Tajudin individually, and the closing memorandum signifying the completion of the transaction was also signed by Tajudin individually as the buyer[2]. Furthermore, no reference is made in the agreement or the closing memorandum to Kauthar. The defendants argue that Rimsat's records also demonstrate that Tajudin, rather than Kauthar, bought and owned the stock. For example, the official stock register of Rimsat identifies "Tajudin Ramli" as the owner of all of the shares of Rimsat Class D stock[3]. The amount paid for the Class D stock according to the official stock register was $38,095,238.

---

2. *See* Affidavit of Kathleen Woodward, Exhibit B.

3. *See* Affidavit of Kathleen Woodward, Exhibit C.

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Moreover, Tajudin, not Kauthar, also exercised the rights of a shareholder with respect to the shares of stock that Kauthar asserts that it purchased. For instance, Tajudin was elected to the Rimsat board of directors and he also elected others to the board by his own vote of shares[4]. The corporate minutes also identify Tajudin as the shareholder of the stock allegedly purchased by Kauthar[5]. The defendants emphasize that in all of these documents, Kauthar is never mentioned, much less identified as the purchaser/owner of the 1800 Class D shares. Thus, the defendants claim that Kauthar does not have standing to pursue the present action against the defendants.

Under Article III of the United States Constitution, the plaintiff must make out a case or controversy between himself and the defendant in order to have standing to sue. *Gladstone Realtors v. Village of Bellwood*, 99 S.Ct. 1601 (1979). Specifically, Article III requires the plaintiff to show that he personally has suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant. *Id.* The constitutional minimum of standing contains three elements: First, the plaintiff must have suffered an

> "injury in fact" — an invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural of hypothetical. Second, there must be a causal connection between the injury and the conduct complained of. . . . Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.

---

4. *See* Affidavit of Kathleen Woodward, Exhibits D, E and F.

5. *See* Affidavit of Kathleen Woodward, Exhibit G.

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United States v. Hays, 132 L.Ed.2d 635, 642 (1995)(quoting *Lujan v. Defenders of Wildlife*, 112 S.Ct. 2130 (1992)).

Additionally, even if the constitutional limitations on standing can be satisfied, a plaintiff can still lack standing under the prudential rules by which federal courts seek to limit access to those litigants best suited to assert a particular claim. *Gladstone Realtors v. Bellwood*, 99 S.Ct. 1601 (1979). Some of the prudential standing limitations on the exercise of federal jurisdiction include:

> the general prohibition on a litigant's raising another person's legal rights, the rule barring adjudication of generalized grievances more appropriately addressed in the representative branches, and the requirement that a plaintiff's complaint fall within the zone of interests protected by the law invoked.

Allen v. Wright, 104 S.Ct. 3315 (1984). *See also FMC Corp. v. Boesky*, 852 F.2d 981, 989 (7th Cir. 1988)(a party that alleges an injury sufficient to satisfy the first element of Article III's case or controversy requirement, still will not have standing if the party fails to fall within the zone of interests protected by a specific federal statute).

Kauthar's complaint alleges that the defendants "solicited Kauthar's investment in the securities of Rimsat"[6] and "induce[d] Kauthar to make a multi-million dollar investment in Rimsat."[7] The complaint further alleges that Kauthar signed a subscription agreement whereby Kauthar agreed to pay

6. Complaint at ¶75.

7. Complaint at ¶77.

$38,095,238 and surrender sixty of Rimsat's Class C shares in exchange for Rimsat's Class D shares. The defendants have taken the position that the documentary evidence in this case demonstrates that Tajudin bin Ramli, and not Kauthar, was involved in the alleged transaction for Class D shares.

Thus, the defendants insist that Kauthar cannot possibly establish that it suffered an injury in fact as a result of the putatively illegal conduct of the defendants. The defendants claim that, according to the recitals in the agreement, the Class C shares exchanged were owned by Tajudin, and not by Kauthar. Further, under the terms of the agreement, Tajudin was given the right to designate himself, or one or more unnamed entities in which he owned an interest as the owner of the stock. The defendants have taken the position that Tajudin signed the agreement on his own behalf, as there is never any mention of Kauthar. The defendants conclude that the subscription agreement demonstrates not only that Tajudin was the actual purchaser of Rimsat's Class D shares, but that Tajudin was acting in his individual capacity, and not on behalf of Kauthar or any other specific entity, during the negotiation and solicitation of his investment in Rimsat. Therefore, if anyone suffered an injury as a result of the alleged wrongful conduct of Nilson, it would have been Tajudin, and not Kauthar. And as Kauthar has suffered no injury, it has no standing to assert the claims made in its complaint.

In response to the defendants' motions for summary judgment, Kauthar argues that Tajudin bin Ramli executed the April 12, 1993 subscription agreement on behalf of Kauthar. To support its position, Kauthar claims that Kauthar, and not Tajudin bin Ramli, owned the sixty shares of non-voting, Class C stock of Rimsat, which shares were exchanged for the Class

D stock that is the subject of the subscription agreement. As noted earlier, the subscription agreement provides that:

> Buyer presently owns sixty (60) shares of non-voting, Class C stock of Rimsat. Buyer wishes to exchange his class C stock for Class D stock and to purchase all of the remaining Class D stock.

Kauthar further points out that the Stock Certificate, dated April 12, 1993, indicated that Kauthar (and not Tajudin) was the owner of 1800 Class D shares of Rimsat. Kauthar has also submitted affidavits from its General Manager, Bistamam Bin Ramli, and its Chairman Tajudin Bin Ramli, verifying that Kauthar is and always has been the buyer of record.

Kauthar has overlooked some very important points. First, the subscription agreement specifically identifies Tajudin as the buyer. The identity of the parties to a contract are to be ascertained from an examination of the written instrument. *Sunman-Dearborn Community School Corp. v. Kral-Zepf-Freitag & Associates*, 338 N.E.2d 707, 709 (Ind. App. 1975). In addition to specifically identifying Tajudin as the buyer, the subscription agreement uses masculine pronouns to identify the buyer, and the notices required pursuant to the agreement were to be sent to Tajudin's offices rather than to Kauthar's offices. Finally, the subscription agreement gives Tajudin the right to "designate himself, or one or more entities in which he has an interest, as the owner(s) of the Class D stock." Thus, Tajudin was not required to designate Kauthar and could have named himself or some other entity as the owner of the shares. The Rimsat stock certificate was signed in blank by Rimsat representatives prior to the closing[8].

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8. Affidavit of Carl B. Hilliard, Jr.

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As the defendants have noted, the fact that Tajudin later may have designated Kauthar as the owner and that payment of the purchase price may have been furnished by Kauthar are irrelevant. That is, Tajudin's mere designation of Kauthar as owner of the stock would not have transferred Tajudin's securities fraud claim to Kauthar, as the Supreme Court has limited claims to the actual purchasers of the securities. *Blue Chip Stamrs v. Manor Drug Stores*, 95 S.Ct. 1917 (1975)(only the actual purchaser of the security has standing under §10(b) and Rule 10b-5). Following the Supreme Court's admonition, the lower courts have repeatedly held that a cause of action for securities fraud does not automatically transfer to subsequent holders of the security. *See e.g., Rose v. Arkansas Valley Environmental & Utility Authority*, 562 F. Supp. 1180, 1189 (W.D. Mo. 1983)(securities fraud claim did not transfer to plaintiffs who had acquired shares by inheritance; plaintiffs had not been personally defrauded and hence lacked standing to sue); *Soderberg v. Gens*, 652 F. Supp. 560, 563 (N.D. Ill. 1987) ("[r]ecent case law interpreting §10(b) is virtually unanimous in concluding that the federal cause of action does not attach automatically to the security itself and pass to the next purchaser"); *In re Nucorp Energy Securities Litigation,* 772 F.2d 1486, 1490 (9th Cir. 1985)(subsequent purchasers of securities did not automatically acquire federal securities claim).

The documents submitted by Kauthar do not support its position that Kauthar was the buyer of the Class D shares. For example, the affidavit of Bistamam bin Ramli states at paragraph 11 that "[p]ursuant to Paragraph (2) of the subscription Agreement, Tan Sri Tajudin Bin Ramli designated Kauthar to be the buyer of each of the 'Class D' shares in Rimsat. . . ." However, paragraph 2 of the subscription

agreement merely provides that "Buyer may designate himself, or one or more entities in which he has an interest, as the *owner(s)* of the Class D stock." Although Kauthar may have ultimately become the *owner* of the Class D stock, it is clear that Tajudin bin Ramli was the *buyer*.

The affidavit of Bistamam bin Ramli further states, at paragraph 12, that "Kauthar was presented by Mr. Simon with Stock Certificate Number 'D-1,' dated April 12, 1993, to evidence Kauthar's *ownership* of each of the 'Class D' shares." Again, evidence of ownership of shares of stock does not equate to evidence of the actual purchase of shares of stock.

Next, the affidavit of Bistamam bin Ramli states, at paragraph 13, that "Mr. Simon, by correspondence dated April 22, 1993, acknowledged again that Kauthar was the actual buyer of the 'Class D' securities." The letter referenced simply states that "Set forth are the instructions for the payment of the money due for the shares issued to Kauthar under the abo e-referenced agreement." The letter does not state that Kauthar was the actual buyer of the shares, and obviously merely refers to Kauthar's subsequent ownership of the shares after transfer from Tajudin bin Ramli pursuant to the agreement. Moreover, even if the letter had stated that Kauthar was the "buyer" of the shares, the subscription agreement, and not the letter, is the controlling document in this case.

Accordingly, as Kauthar has failed to support its argument that it was, in fact, the buyer of the shares at issue in the present case, this court will grant the defendants' motions.

Kauthar next argues that even if it does not have standing to bring this suit against the defendants, the proper remedy is

merely retroactive amendment of the complaint, to permit renaming of the plaintiff, with no substantive effect whatsoever on this matter. Kauthar relies on Rule 17(a) of the Federal Rules of Civil Procedure, which provides:

> No action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest; and such ratification, joinder or substitution shall have the same effect as if the action had been commenced in the name of the real party in interest.

Clearly, however, the defendants are correct in their assertion that Kauthar has confused the concepts of standing and real party in interest. Standing and real party in interest are two distinct concepts. *Weissman v. Weener*, 12 F.3d 84, 86 (7th Cir. 1993); *Kent v. Northern Cal. Reg. Off. of Amer. Friends Serv. Com.*, 497 F.2d 1325, 1329 (9th Cir. 1974); *Sohrag v. Dinges*, 825 F. Supp. 954, 958 (D.Kan. 1993), *aff'd* 73 F.3d 374 (10th Cir. 1993). Real party in interest is not jurisdictional and may be waived if not raised in a timely fashion. *Id.*; *Schrag*, 825 F. Supp. at 959. Standing, however, is a jurisdictional requirement which may be raised at any stage of the litigation. *N.O.W. v. Scheidler*, 114 S.Ct. 798 (1994); *Animal Legal Defense Fund, Inc. v. Espy*, 29 F.2d 720, 723 n.3 (D.C.Cir. 1994). Standing considerations which define and limit the role of the courts are threshold determinations of the propriety of judicial intervention. *Warth v. Seldin*, 95 S.Ct. 2197 (1975). Consequently, since judicial intervention is inappropriate where standing does not exist, this court has no choice but to dismiss the present action.

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Conclusion

For all of the foregoing reasons, the defendants motions for summary Judgment are hereby GRANTED.

Enter: April 14, 1997.

s/ William C. Lee
William C. Lee, Chief Judge
United States District Court

APPENDIX G — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DENYING PETITION FOR REHEARING DATED AUGUST 12, 1998

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

August 12, 1998

Before

Hon. WALTER J. CUMMINGS, Circuit Judge

Hon. KENNETH F. RIPPLE, Circuit Judge

Hon. ILANA DIAMOND ROVNER, Circuit Judge

No. 97-2795

KAUTHAR SDN BHD, a Malaysian corporation,

Plaintiff-Appellant,

v.

MICHAEL A. STERNBERG, an individual and citizen of the State of Illinois, JAMES A. SIMON, an individual and citizen of the State of Indiana, CARL B. HILLIARD, JR., et al.,

Defendants-Appellees.

Appendix G

Appeal from the United States District Court for the Northern District of Indiana, Fort Wayne Division

No. 95 C 199

William C. Lee, Chief Judge.

ORDER

On consideration of the petition for rehearing filed by the appellant on July 28, 1998, the judges on the panel have voted to deny the petition. Accordingly,

IT IS ORDERED that the petition for rehearing be, and the same is hereby, DENIED.

APPENDIX H — JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF INDIANA DATED AND FILED APRIL 14, 1997

United States District Court
Northern District of Indiana

Case No. 1:95-cv-199.

KAUTHAR SDN BHD

Plaintiff

v.

MICHAEL A. STERNBERG, JAMES A SIMON, CARL B. HILLIARD, MATT C. NILSON, FRIENDLY ISLANDS SATELLITE COMMUNICATIONS, LTD., LARRY RISER, W. L. PRITCHARD & CO., SHARON E. HILLIARD, DENISE SIMON, NILSON RESEARCH CORP., JERRY J. FLETCHER, SALOTE MAFILEO PILOLEVU TUITA

Defendants

JUDGMENT IN A CIVIL CASE

[ ] **Jury Verdict.** This action came before the court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

[X] **Decision by Court.** This action came to consideration before the Court. The issues have been determined and a decision has been rendered.

Appendix H

IT IS ORDERED AND ADJUDGED judgment is entered in favor of the defendants Dr. Matt C. Nilson, Nilson Research Corporation, Carl B. Hilliard, Jr., Sharon E. Hilliard, James A. Simon, Michael S. Sternberg, Friendly Islands Satellite Communications, Ltd., Her Royal Highness Princess Salote Mafileo Pivolevu Tuita, Jerry J. Fletcher, and W. L. Pritchard & Co., Inc. and against the plaintiff, Kauthar SDN BHD. Further, Counts I, III, IV, IX, X, XI, XII, XIII, and XIV of the plaintiff's amended complaint are DISMISSED. Additionally, the plaintiff Kauthar's securities fraud claims are DISMISSED for lack of subject matter jurisdiction, and plaintiff's securities claims asserted in Count I and Count IV of its amended complaint are DISMISSED as barred by statute of limitations. Kauthar's fraud claims are DISMISSED for failure to comply with the requirements of Rule 9(b) of the Federal Rules of Civil Procedure.

This document entered pursuant to Rules 79(A) and 58 of the Federal Rules of Civil Procedure on:

Dated: April 14, 1997

Equivalent Coupon Issue Yield: 6.00

Stephen R. Ludwig, Clerk

by s/ [illegible]
Deputy Clerk

APPENDIX I — ORDER OF FINAL JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF INDIANA, FORT WAYNE DIVISION FILED JUNE 24, 1997

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

Case No. 1-95-CV-199

Judge William C. Lee

KAUTHAR SDN BHD, a Malaysian corporation

Plaintiff,

v.

MICHAEL A. STERNBERG, et al.,

Defendants.

ORDER OF FINAL JUDGMENT

Defendants, Carl B. Hilliard, Jr. and Sharon E. Hilliard, have presented a Proposed Final Judgement in this case and have served a copy of the same on counsel for plaintiff and co-defendants. This proposed final judgment is said to have been submitted in response to Plaintiff's motion for a certification pursuant to Fed. R. Civ. P. 54(b) and in the interest of economizing the time of the Court and the parties. The Court finds that a hearing is not required in this matter and concludes that the plaintiff's request for certification under Rule 54(b) should be granted.

Appendix I

This case involves multiple parties and more than one claim for relief. This Court granted defendants' motions for summary judgment as to the First Amended Complaint on April 14, 1997. This Court also granted various motions to dismiss the First Amended Complaint in whole and in part. The Court set forth the reasons for its decisions in extensive orders of April 14, 1997. These decisions and orders also render all of the defenses and derivative counter claims with respect to the First Amended Complaint moot. Also moot are the various cross claims for indemnity and contribution. *Holcomb v. Allis-Chalmers Corp.*, 774 F.2d 398, 400 (10th Cir. 1985). This Court finds that there are no written motions filed in this case which need be disposed of before final judgment is rendered. The Court's decisions have disposed of all of plaintiff's claims and meet the standard of finality set forth in 28 U.S.C. § 1291. *W.L. Gore & Associates v. International Medical Prosthetics Research Assocs., Inc.*, 975 F.2d 858, 863 (Fed. Cir. 1992).

On an earlier date, this Court entered a default judgment against defendant Larry Risser. In view of its findings in the decisions noted above, the Court *sua sponte* sets aside this judgment, and enters an order of dismissal in favor of defendant Risser.

Still pending are various cross claims filed by Matt C. Nilson and Carl B. Hilliard against the plaintiff and certain individual defendants. This Court has entered an order staying these proceedings until further notice.[1] A judgment disposing

1. The same cross-claims have been filed in *Underwood v. Simon*, N.D. Ind. Bnkrp. Case No. 97-1003. A disposition of these claims on the merits in that Court may render further proceedings in this Court moot. The delay of pending litigation of crossclaim in another forum justifies entry of a Rule 54(b) judgment. *Bank of Lincolnwood v. Federal Leasing, Inc.*, 622 F.2d 944, 950 (7th Cir. 1980).

of a main claim may be properly entered under Rule 54(b) despite the presence of a pending counter claim, if the issues presented by the counter-claim are distinct. *Shintom America, Inc. v. Car Telephones, Inc.*, 45 F.3d 1107, 1110-1011 (7th Cir. 1995). Generally speaking, the cross-claims are based on the alleged misconduct of plaintiff as controlling shareholder and the other cross-defendants as directors of Rimsat. The plaintiff's claim is based on allegations of misrepresentations and misconduct incident to the sale and purchase of Rimsat stock. Thus, the adjudicated and unadjudicated claims are distinct and separate and do not arise from the same transaction.

These cross-claims were filed under the liberal joinder rules set forth in Fed. R. Civ. Pro. §§ 18 & 20. Although there is some overlap in the factual contentions of the First Amended Complaint, the cross claims are distinct claims and they are factually separate and independent from the claims set forth in the First Amended Complaint. It would be inequitable to delay plaintiff's appeal until, when or if, the cross claims are finally determined. Further, since such cross claims presents separate and distinct claims, duplicative appellate review will not result from an appeal of the final disposition of these claims. *Walker v. Maccabees Mutual Life Ins. Co.*, 753 F.2d .599, 601 (7th Cir. 1985).

Fed. R. Civ. P. 54(b) allows a district Court to direct the entry of final judgment as to one or more but fewer than all of the claims in a case "upon an express determination that there is not just reason for delay and upon express direction for the entry of judgment". Rule 54(b) provides that if multiple claims are presented, "whether as a claim, counterclaim, cross-claim or third-party claim," a final judgment may be entered on any of the claims. A dismissal of a claim may be properly entered

as a final judgment under Rule 54(b). *Stearns v. Consolidated Management,* 747 F.2d 1105, 1108-1109 (7th Cir. 1984). A judgment is "final" in the sense that it is "an ultimate disposition of an individual claim entered in the course of a multiple claims action." *Curtiss-Wright Corp. v. General Elec. Co.*, 446 U.S. 1, 7, 100 S. Ct. 1460, 1464, 64 L. Ed. 2d 1 (1980), *quoting; Sears, Roebuck & Co. v. Mackey,* 351 U.S. 427, 436, 76 S. Ct. 895, 900, 100 L. Ed. 1297 (1956).

This Court has made a final adjudication as to all of plaintiff's claims in this action. The Court finds that there is no reason to delay plaintiff's appeal of its decision because it would be inequitable to require plaintiff to wait until when and if the cross claims are finally determined and because the cross claims are not so closely related as to present a substantial risk of duplicative appellate review. Since the plaintiff has filed a notice of appeal, this Rule 54(b) certification will establish appellate jurisdiction *nunc pro tunc. Lac Courte Oreilles Band v. Wisconsin,* 760 F.2d 177, 180-181 (7th Cir, 1985).

WHEREFORE, the Clerk of this Court is directed to enter the following Final Judgment in this case:

FINAL JUDGMENT

IT IS HEREBY ORDERED AND ADJUDGED that:

1. A judgment was entered herein on April 14, 1997 in favor of the defendants on all counts of the First Amended Complaint, and, in addition, dismissal was ordered as to certain of those counts on alternate grounds.

2. The Court now determines, under Rule 54(b) FRCP, that there is no just reason for delay in entering final judgment upon the First Amended Complaint, and hereby grants that final judgment on the First Amended Complaint be entered; and the same hereby is entered.

ENTERED this day of 24 day of June, 1997.

s/ William C. Lee
HON. WILLIAM C. LEE,
U. S. District Judge

JUDGMENT ENTERED:

s/ [illegible], Deputy
CLERK, U. S. District Court

Supreme Court, U.S.
FILED
DEC 17 1998
OFFICE OF THE CLERK

No. 98-799

IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

KAUTHAR SDN BHD,

Petitioner,

vs.

MICHAEL A. STERNBERG, *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the one-year limitations period established by Section 9(e) of the Securities Exchange Act of 1934 for claims under Section 10(b) of the Act and SEC Rule 10b-5 begins to run when the plaintiff becomes aware of facts that would lead a reasonable person to investigate whether fraud has occurred, or when the plaintiff actually discovers the fraud.

2. Whether the payment of a finders' fee to corporate insiders was sufficiently central to the alleged fraudulent scheme so that notice of the finders' fee was sufficient to place plaintiff on notice of other aspects of the scheme.

3. Whether the court of appeals erred by not remanding the state fraud claims after having affirmed dismissal of the federal claims.

LIST OF PARTIES

The petition accurately lists the parties to the petition.

RULE 29.6 LISTING

Respondents Friendly Islands Satellite Communications, Ltd. and Nilson Research Corporation do not have any parent corporations or nonwholly owned subsidiaries.

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OPINIONS BELOW

The opinion of the court of appeals is reported at 149 F.3d 659 and is printed in Petitioner's Appendix (Pet. App. 1a-30a). The district court's opinions and orders are unreported and are printed in Pet. App. 33a-38a, 39a-59a, 60a-111a, 112a-125a, 128a-129a and 130a-134a.

STATEMENT OF JURISDICTION

The judgment of the court of appeals was entered on July 14, 1998. The court denied a petition for rehearing on August 12, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

Petitioner brought this securities fraud suit after having lost a $38 million investment in Rimsat, Ltd., a company formed to provide communication satellites to customers in the Pacific Rim region. The complaint included a count under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5. The district court dismissed that count for failure to comply with the one-year limitations period in Section 9(e) of the 1934 Act. 78 U.S.C. § 78i(e). The court of appeals affirmed on the ground that petitioner "was aware of sufficient facts to enable it to learn that it had a cause of action for fraud against the defendants more than one year before it filed suit." Pet. App. 25a-26a.

Central to the fraud charge was petitioner's allegation that a significant portion of the initial investment, instead of being used for constructing satellites or launch vehicles and leasing orbital positions, was diverted to a finders' fee paid to a Hong Kong corporation controlled by one or more insiders. Pet. App.

24a. Petitioner conceded that it had learned of the finders' fee more than one year before suit and had initiated an investigation, but stopped the investigation after receiving a letter dated September, 1, 1993 from Hilliard, one of the insiders and later a defendant, stating that he had not received any monies from the fee. Pet. App. 52a. Petitioner then waited 17 months before filing suit against Rimsat's principals and others in March, 1995, six weeks after a petition placing Rimsat in bankruptcy was filed. Pet. App. 4a. Petitioner claimed that it learned after the bankruptcy filing that Hilliard and other insiders had shared the finders' fee. Pet. App. 54a.

The district court concluded that petitioner had not explained "why, based on Hilliard's letter alone, it decided to halt its investigation, thus ignoring the 'storm warning' that aroused its suspicions." Pet. App. 54a. The court of appeals agreed, pointing out that, as part of the investment agreement, petitioner was represented on Rimsat's Board of Directors and had the power to appoint one half of the directors. Pet. App. 25a. Consequently, petitioner had "ready access to the financial information of the company." *Id.* In these circumstances, the court of appeals concluded, once petitioner learned of the finders' fee, it was "able . . . to ascertain the information needed to file suit," and its "obligation to inquire was [not] satisfied even if one of the defendants told [it] that he had not received any of those diverted funds." Pet. App. 25a and n.15.

ARGUMENT

In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), this Court held that private suits under § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 are subject to the federal statute of limitations in § 9(e) of the Act. Section 9(e) provides that suit must be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e).

After *Lampf* was decided, the courts of appeals of six Circuits — the Second, Fourth, Fifth, Seventh, Eighth and Tenth — applied the so-called "inquiry notice" standard to Section 9(e). Cases cited at Pet. 14-15. Under this standard, "discovery" takes place when the plaintiff receives either actual knowledge of facts giving rise to the action "or notice of the facts, which in the exercise of reasonable diligence, would have led to actual knowledge." *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2d Cir. 1993), quoting *Kahn v. Kohlberg, Kravis, Roberts & Co.*, 970 F.2d 1030, 1042 (2d Cir.), *cert. denied*, 506 U.S. 986 (1992). No court of appeals has held that Section 9(e) requires actual knowledge of the facts giving rise to the action.

In the court of appeals, petitioner's only argument on the statute of limitations issue was that the facts alleged in the complaint were not sufficient to establish inquiry notice prior to the limitations period. In this Court, however, petitioner raises for the first time the issue of whether actual notice rather than inquiry notice is required to start the one-year limitations period.

1. It is only in "exceptional cases" that this Court reviews "questions not pressed or passed upon below." *Duignan v. United States*, 274 U.S. 195, 200 (1927). The present case is not "exceptional." The inquiry notice issue is not jurisdictional, is not a predicate to any constitutional issue in the case, does not constitute "plain error," and implicates none of the other reasons justifying a departure from the normal rule that "this Court does not decide questions not raised or involved in the lower court." *Youakim v. Miller*, 425 U.S. 231, 234 (1976); *Breininger v. Sheet Metal Workers Intern.*, 493 U.S. 67, 94 (1989). *See* Stern, Gressman *et al.*, *Supreme Court Practice* (7th ed.) at § 6.26.

2. In any event, the decision below was correct. In *Lampf*, this Court held that the limitations period in Section 9(e) of the Securities Exchange Act of 1934 governs private securities fraud claims under Section 10(b). Section 9(e) provides that the limitations period is one year after "discovery of the facts constituting the violation." 15 U.S.C. § 78i(e). Since *Lampf*, the courts of appeals have unanimously held that "discovery" under Section 9(e) includes "constructive and inquiry notice as well as actual notice." *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346 (2d Cir. 1993), *cert. denied*, 511 U.S. 1019 (1994); *Howard v. Haddad*, 962 F.2d 328 (4th Cir. 1992); *Topalian v. Ehrman*, 954 F.2d 1125, 1133 (5th Cir.), *cert. denied*, 506 U.S. 825 (1992); *Tregenza v. Great American Communications Co.*, 12 F.3d 717 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994); *Anixter v. Home-Stake Production Co.*, 947 F.2d 897 (10th Cir. 1991), *vacated on other grounds, sub nom. Dennler v. Triplett*, 503 U.S. 978 (1992).

These decisions accord with a long line of pre-*Lampf* cases under both state and federal statutes. Under Section 29(b) of the 1934 Act, which provides — in language indistinguishable from Section 9(e) — that suit must be brought "within one year after the discovery that such sale or purchase involves such violation,"[1] the Fifth Circuit has held that

> "[d]iscovery" . . . is to be determined . . . according to an objective standard; that is, "discovery" means either actual knowledge or notice of facts which, in the exercise of due diligence, would have led to actual knowledge of the violation.[2]

Several cases have held that inquiry notice is sufficient to start the limitations period running under state statutes requiring

1. 15 U.S.C. § 78cc(b).

2. *Goldenberg v. Bache and Company*, 270 F.2d 675, 681 (5th Cir. 1959).

"discovery by the aggrieved party of the facts constituting the fraud"[3] or "discovery of the fraud"[4] — language indistinguishable from the formulation of Section 9(e) ("discovery of the facts constituting the violation"). There are no contrary decisions under Section 9(e).

The case law adopting the inquiry notice standard stems from decisions antedating the 1934 Act. In *Curtis v. Connly*, 257 U.S. 260, 264 (1921), this Court applied inquiry notice under a state statute providing that a fraud action accrues when the plaintiff "shall first discover its existence."[5] And in *Bailey v. Glover*, 88 U.S. (21 Wall.) 342, 349 (1874), the Court announced that it would construe federal statutes of limitation in light of the general equitable principle that a cause of action for fraud does not begin to run until the fraud is discovered

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3. *Busenius v. Horan*, 769 P.2d 869, 872 (Wash. App. 1989), applying Wash. Rev. Code § 4.16.040; *Hilton v. Mumaw*, 522 F.2d 588, 595 (9th Cir. 1975) (also applying Washington statute); *Koulis v. Standard Oil Company of California*, 746 P.2d 1182, 1185 (Utah App. 1987), applying Utah St. § 78-12-26(3); *North Carolina National Bank v. Carter*, 322 S.E. 2d 180, 184 (N.C. App. 1984), applying N.C. Stat. § 1-52(9); *Turley v. Turley*, 649 P.2d 434, 440 (Sup. Ct. Mont. 1982), applying MCA § 27-2-203; *Stafford v. Mississippi Valley Title Insurance Co.*, 569 So. 2d 720, 724 (Sup. Ct. Ala. 1990); *Sexton v. Liberty National Life Ins. Co.*, 405 So. 2d 18, 20-21 (Sup. Ct. Ala. 1981), applying Ala. Code 1975 § 6-2-3.

4. *A.C. Heise v. Pilot Rock Lumber Co.*, 352 P.2d 1072, 1079 (Or. Sup. Ct. 1960), applying Or. St. § 12.110; *Jennings v. Jennings*, 507 P.2d 241, 249 (Sup. Ct. Kan. 1973), applying K.S.A. § 60-513; *Dzenits v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 494 F.2d 168, 171 (10th Cir. 1974), relying on *George H. McFadden & Bro., Inc. v. Home-Stake Production Co.*, 295 F. Supp. 587, 589 (N.D. Okla. 1968) (quoting Oklahoma statute).

5. *See also Tregenza v. Great American Communications Co.*, 12 F.3d 717, 722 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994), discussing other Supreme Court decisions.

"when there has been no negligence or laches on the part of a plaintiff in coming to the knowledge of the fraud."

Petitioners argue that *Lampf* requires a contrary result. However, *Lampf* merely decided that Section 9(e) applies to claims under Section 10(b). The Court did not discuss how Section 9(e) should be interpreted. Petitioner quotes the Court's statement that under Section 9(e) the action must be commenced within one year of "discovery of the facts constituting the violation." *Lampf*, 501 U.S. at 364. But that statement merely tracks the statutory language, without discussing what constitutes "discovery." Nor did the Court give any indication that it intended to overrule the substantial body of law interpreting statutes with identical language to incorporate the inquiry notice standard.

Petitioners argue that Section 9(e)'s failure to include explicit language incorporating an inquiry notice standard must be taken as rejection of that standard, because Section 13 of the 1933 Act includes such explicit language. 15 U.S.C. § 77m. However, when Congress passed Section 9(e) in 1934, it did not know that later judicial construction would apply the statute to fraud claims; the explicit terms of the statute apply to claims of manipulation of prices on a national exchange or violation of SEC rules on puts, calls, straddles or options. 15 U.S.C. § 78i(e). Thus Congress had no reason to address the issue of inquiry notice in fraud cases, and no inference can be drawn from its silence. And in any event, Congress had every reason to believe that, if the statute were judicially extended to fraud claims, the inquiry notice standard traditionally applied by the courts to such claims would govern. *Bailey v. Glover*, *supra*; *Curtis v. Connly*, *supra*. By contrast, Section 13 expressly applies to fraud claims,[6] and thus Congress had a good reason to address the inquiry notice issue expressly.

6. Section 13 applies to liability for false registration, and for sale of securities by use of false or misleading prospectuses or oral statements. 15 U.S.C. § § 77m, 77k, 77*l*(2).

Petitioners argue that the inquiry notice standard has been inconsistently applied, citing the Tenth Circuit's decision in *Sterlin v. Biomune Sys.*, 154 F.3d 1191 (10th Cir. 1998). But the only inconsistency identified by the Tenth Circuit relates to the issue of whether the statute begins to run on "the date Plaintiff was allegedly placed on inquiry notice" or on "the date Plaintiff claims he could reasonably have discovered the facts underlying the alleged fraud." *Sterline*, 154 F.2d at 1201. That narrow issue regarding the interstices of the inquiry notice standard is far different from the "inquiry notice" vs. "actual notice" issue which petitioner attempts to raise for the first time in this Court. Petitioner never argued that, once having been placed on notice of the finders' fee 17 months before filing suit, its representatives on the company's Board of Directors could not have discovered within less than five months the remaining pertinent facts. There was ample basis for the court of appeals' conclusion that petitioner "was aware of sufficient facts to enable it to learn that it had a cause of action for fraud against the defendants more than one year before it filed suit." Pet. App. 25a-26a.

Finally, petitioners argue that the decision of the court below will place investors under compulsion to investigate and sue upon "the slightest irregularity in the performance of his or her investment." Petition at 16. That is a gross exaggeration. The inquiry notice standard was the prevailing rule for many years. It was applied by the federal courts that borrowed state statutes of limitation for § 10(b)(5) claims before *Lampf*.[7] The

7. The pre-*Lampf* decisions borrowing state statutes of limitation for § 10(b) claims applied federal law to determine the date on which the statute of limitations begins to run, and held that "[u]nder federal law a statute of limitations begins to run 'when the fraud is or should have been discovered,' " with the plaintiff having "a positive duty to use diligence in discovering the existence of a cause of action." *Herm v. Stafford*, 663 F.2d 669, 682 (6th Cir. 1981), quoting *Vanderboom v.* (Cont'd)

two Circuits that applied a federal statute of limitations before *Lampf* did so for only a brief period, having previously also applied state limitations periods to § 10(b) claims in conjunction with the federal notice inquiry standard.[8] Thus before *Lampf* the notice inquiry standard prevailed. And, as petitioners concede, the notice inquiry standard has also been applied by the six Circuits that have considered the issue post-*Lampf*.[9] If the notice inquiry standard were to produce the "race to the courthouse" predicted by petitioners (Petition at 17), such a stampede would have been evident by now. In fact, of course, none has materialized.

As the Seventh Circuit pointed out, jettisoning the inquiry notice standard would mean that investors typically could wait for the full three-year period of repose before suing. Yet "[t]hree years is an age in the stock market." *Tregenza v. Great American Communications Co.*, 12 F.3d 717, 722 (7th Cir. 1993), *cert.*

(Cont'd)
Sexton, 422 F.2d 1233, 1240 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); *Arneil v. Ramsey*, 550 F.2d 774, 780-81 (2d Cir. 1977).

8. Before *Lampf*, only the Third and Seventh Circuits applied federal periods of limitation to § 10(b) claims. These Circuits adopted that rule only a few years before *Lampf*, in each case overruling prior Circuit precedent applying state limitations periods. *In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir.) (en banc), *cert. denied*, 488 U.S. 849 (1988); *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 501 U.S. 1520 (1991). The prior Circuit precedent had held that federal law determined when the state period of limitation starts to run, and under federal law the period starts to run when the plaintiff should have discovered the facts. *Biggans v. Bache Halsey Stuart Shields*, 638 F.2d 605, 607 n.3 (3d Cir. 1980); *Tomera v. Galt*, 511 F.2d 504, 509-10 (7th Cir. 1975) (stating that actual discovery is required only where the defendant has taken positive steps to conceal the fraud).

9. *See* Cases cited in Petition at 14-15.

denied, 511 U.S. 1085 (1994). Routinely allowing investors three years to sue, even where they know something might be wrong and have the means to investigate, would encourage

> the opportunistic use of federal securities law to protect investors against market risk. . . . If the stock rebounded from the cellar they would have investment profits, and if it stayed in the cellar they would have legal damages. Heads I win, tails you lose.

Id. There is no reason to believe that Congress intended Section 9(e) to encourage this tactic by altering the standard that has traditionally been applied by federal and state courts in both securities and non-securities fraud litigation.

3. Petitioner argues that even if it was on notice of the diversion of funds to insiders through a finders' fee, there were other unrelated aspects of its fraud claim as to which it was not on notice. However, in the district court petitioner "stresse[d] that the [finders' fee] is, in its view, a critical component of the fraud that it is trying to establish." Pet. App. 52a. The court of appeals agreed, concluding that petitioner's knowledge of the finders' fee and its position on the company's Board of Directors should have been sufficient to prompt an investigation of the entire matter. There is no occasion for this Court to review the conclusion of the courts below on this essentially fact-specific issue.

4. Finally, petitioner argues that the court of appeals should have let its state-law claims go to trial, even if its federal claims were properly dismissed. However, nowhere in its brief before the court of appeals did petitioner argue for separate treatment of its state claims, other than in a footnote referring to a trial

court brief on the issue. As the court of appeals correctly ruled with respect to another such instance in petitioner's brief in the court of appeals a footnote in an appellate brief referring to a trial court brief is not sufficient to preserve an issue for appellate review. Pet. App. 19a.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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No. 98-799

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

KAUTHAR SDN BHD,
Petitioner,

v.

MICHAEL A. STERNBERG, *et al.*
Respondents.

On Petition for a Writ of Certiorari To The United States Court of Appeals For the Seventh Circuit

MOTION FOR LEAVE TO FILE A BRIEF *AMICI CURIAE* AND BRIEF OF AMERICAN ASSOCIATION OF RETIRED PERSONS AND CONSUMER FEDERATION OF AMERICA IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE A BRIEF *AMICI CURIAE* OF AMERICAN ASSOCIATION OF RETIRED PERSONS AND CONSUMER FEDERATION OF AMERICA IN SUPPORT OF PETITIONER

The American Association of Retired Persons and Consumer Federation of America respectfully move for leave to file the accompanying brief as *amici curiae* in support of the first question presented in Kauthar Sdn Bhd's Petition for a Writ of *Certiorari* from the judgment of the U.S. Court of Appeals for the Seventh Circuit.

Pursuant to Supreme Court Rule 37.2, consent of the parties to the filing of the brief was sought through counsel. Counsel for Petitioner gave consent, but counsel for Respondents declined to do so.

STATEMENT OF INTEREST OF *AMICI CURIAE*

The American Association of Retired Persons (AARP) is a not-for-profit membership organization serving more than 32 million people aged 50 and older. As the largest membership organization representing the interests of older Americans, AARP is very concerned about fraud in the securities industry. The Federal Trade Commission estimates that Americans lose more than $1 billion each year in fraudulent investments. Such practices can wipe out savings accumulated during a person's lifetime for use during retirement. Older people are frequent targets of fraud, since they often have significant assets and are concerned about supplementing the Social Security and pension benefits they will receive during retirement. AARP thus has made the need to combat securities fraud a high priority, and opposes efforts to limit federal statutory remedies that allow defrauded investors to obtain financial redress. The Association has been very involved in commenting on legislative and regulatory proposals that address this issue, and in educating

consumers about how to choose financial professionals and to make sure the people they hire act in the customers' best financial interest.

Consumer Federation of American (CFA) is a non-profit association organized in 1968 to advance the interests of consumers through advocacy and education. CFA's current membership is comprised of approximately 250 national, state, and local consumer groups throughout the United States which, in turn, represent more than 50 million consumers.

Recognizing the growing participation of American consumers in our nation's financial markets, CFA has made protecting the interests of individual investors a priority. The guiding principle behind CFA's work on these issues is that investors deserve effective protection from fraud, fair dealing from financial professionals, and full and timely disclosure of information relevant to their interests. In keeping with these concerns, CFA has supported federal and state legislative and regulatory initiatives on a broad array of investor protection issues, including financial planner regulation, penny stock fraud, abuses associated with limited partnership rollups, rights to redress for victims of securities fraud (both in court and through arbitration), industry compensation practices, and plain English disclosures.

These issues have grown in importance as the need to use stock investments to supplement Social Security and pension benefits has increased. While individuals increasingly must fund their own retirement plans, the growing complexity of the securities marketplace makes it more difficult for consumers to understand which investments are suitable for their short- and long-term financial goals. AARP and CFA thus are involved in efforts to combat the high levels of financial illiteracy common among individual investors. For example, AARP and CFA are among the original members of the Securities and Exchange Commission's (SEC) Consumer Advisory Panel, formed by Chairman Levitt to provide advice

on issues that affect individual investors, and both organizations participated on several expert panels as part of the SEC's "Savings and Investing" Week, to help educate investors about the basics of saving for retirement.

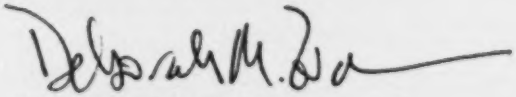
In April 1998, AARP conducted a survey of investor awareness of broker compensation practices. The survey revealed that investors do not have a basic understanding of the conflicts of interest that may arise because of brokerage industry compensation practices, such as sales contests or enhanced commissions for the sale of proprietary products. AARP released consumer education materials to help investors understand how the brokerage industry's compensation system may affect the returns they receive on their investments.

In addition, AARP has worked with the Federal Trade Commission to produce a guide entitled, "Facts About Financial Planners," which provides information and assistance to investors about how to find a professional who is qualified to provide financial advice. In 1995, AARP, CFA, and the North American Securities Administrators Association released a "Bulletin for Older Investors," which advised investors about how to map out their financial goals, select a financial professional, and understand basic investment terms. The Bulletin was directed toward the many relatively inexperienced investors who may be facing investment decisions for the first time, due to the receipt of a lump sum pension payment or proceeds from the sale of a home.

The interest of *amici* in this case stems from their positions among the leading consumer organizations in this country involved in matters concerning protecting investors from fraud, and the substantial interests at stake for their members and the consumers they serve. AARP and CFA believe that the holdings of various Circuit Courts, if allowed to stand, will have serious adverse consequences for individual

investors. *Amici* respectfully suggest that it will be useful to the Court, in reviewing the Petition for a Writ of *Certiorari,* to consider their views on the importance of correcting the appellate courts' refusal to follow this Court's precedent stating that discovery of the facts constituting a violation, i.e., actual notice of fraud, triggers the one-year statute of limitations in actions under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j(b) (West 1997), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1998).

Respectfully submitted,



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No. 98-799

IN THE
Supreme Court of the United States
OCTOBER TERM, 1998

KAUTHAR SDN BHD,

Petitioner,

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MICHAEL A. STERNBERG, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEAL
FOR THE SEVENTH CIRCUIT

BRIEF *AMICI CURIAE* OF AMERICAN ASSOCIATION OF RETIRED PERSONS AND CONSUMER FEDERATION OF AMERICA IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST OF *AMICI CURIAE*[1/]

The interest of *amici* is set forth in the preceding Motion for Leave to File this brief.

REASONS FOR GRANTING THE WRIT

The strength and stability of America's securities markets depends, to a large extent, on investor confidence in the fairness and efficiency of the marketplace. Critical to maintaining this confidence is the availability of effective remedies against those who violate federal statutory anti-fraud provisions. Congress recognized this when it enacted § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (West 1997), "'to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions[.]'" *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 508 U.S. 286, 296 (1993), quoting *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986). Many experts consider § 10(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1998), to be the core provisions of the federal securities laws that prohibit fraud against investors. For example, the Securities and Exchange Commission (SEC), which promulgated Rule 10b-5 under its authority to enforce the federal securities laws, has stated:

> As the law has developed, Rule 10b-5 is vastly more important in combating fraud than are the express remedies provided in the 1933 and 1934 Acts. . . . Section 10(b) and Rule 10b-5 have

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[1/] No counsel for any party authored any portion of this brief. No person or entity other than *amici*, their members, or their counsel has made a monetary contribution to the preparation and submission of this brief.

> come to embrace a diversity of claims which could not have been envisioned in 1934.

Br. *Amicus Curiae* of SEC at 23, *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991) (No. 90-333).

While Congress did not expressly create a private cause of action under § 10(b), this Court has found that an implied right of action exists to encourage private enforcement of this anti-fraud provision. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976) ("the existence of a private cause of action for violations of the statute and the Rule is now well established."); *Basic Inc. v. Levinson*, 485 U.S. 224, 230-31 (1988) (private actions under § 10(b) "constitute[] an essential tool for enforcement of the 1934 Act's requirements."); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 & n.10 (1983) (the existence of an implied private right of action is today "simply beyond peradventure."). Moreover, this Court and the SEC repeatedly have cited the availability of private lawsuits as critical to effective enforcement of federal securities laws, and to maintenance of investor confidence in the integrity, fairness, and efficiency of the securities marketplace. For example, this Court stated that private actions provide "'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'" *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985), quoting *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964).

The SEC has echoed this view. In testimony concerning litigation under the federal securities laws, SEC Chairman Arthur Levitt stated:

> The Commission has consistently stressed the importance of private actions under the anti-fraud provisions of the federal securities laws. In order to maintain investor confidence in the fairness of

> our securities markets, we must ensure that investors have a meaningful right to seek recovery against those who defraud them. . . . Preserving private actions as a source of deterrence and as the primary vehicle for compensating defrauded investors will be increasingly important as our securities markets continue to grow in size and complexity.

Securities Litigation Reform: Hearings Before the Subcomm. on Telecommunications & Finance of the House Comm. on Energy and Commerce, 103d Cong. 33 (1994) (testimony of Arthur Levitt).

The Director of the agency's Division of Enforcement expressed similar sentiments:

> Due to the Commission's inability to address all violations, the implied private right of action under Section 10(b) and Rule 10b-5 thereunder is critically important to the effective operation of the federal securities laws. . . . Given the continued growth in the size and complexity of our securities markets, and the absolute certainty that persons seeking to perpetuate financial fraud will always be among us, private actions will continue to be essential to the maintenance of investor protection.

Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 103d Cong. 111,113 (1993) (testimony of William R. McLucas).

The federal appeals courts' use of inquiry notice to trigger the statute of limitations undermines the ability of defrauded investors to use this important tool, in direct contravention of this Court's holding in *Lampf*. Accordingly, *amici* urge the

Court to grant a writ of *certiorari* in order to reaffirm its ruling that the limitations period is triggered by actual notice and, thereby, to preserve court access for victims of securities fraud.

I. THE FEDERAL CIRCUIT COURTS' REFUSAL TO FOLLOW THIS COURT'S PRECEDENT APPLYING AN ACTUAL NOTICE STANDARD PLACES AN UNDUE BURDEN ON INDIVIDUAL INVESTORS.

A. Inquiry Notice Effectively Reduces An Already Short Statute of Limitations Period.

In *Lampf*, this Court was asked to determine the applicable statute of limitations for private actions brought under § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. Operating within a less than clear statutory framework, which does not provide for private claims and which contains several express causes of action each with its own limitations period, the Court nevertheless adopted a clear standard, namely, the one-year statute of limitations contained in § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e). The Court just as clearly held that the "1-year period, by its terms, begins after discovery of the facts constituting the violation . . . ." *Lampf*, 501 U.S. at 363.

Of particular importance to the current proceeding, the Court considered and expressly rejected the triggering mechanism contained in § 13 of the Securities Act of 1933, 15 U.S.C. § 77m. Actions under that section must be brought "within one year after the discovery of the untrue statement or the omission, *or after such discovery should have been made by the exercise of reasonable diligence*. . . ." *Lampf*, 501 U.S. at 360 n.7 (emphasis added).

In so doing, the Court stated that the SEC had correctly noted that the

> periods contained in the 1934 and 1933 Acts differ slightly in terminology. To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e).

Id. at 364 n.9.

Despite this clear language, federal courts of appeal continue to apply an inquiry notice standard. It is noteworthy, for example, that the Seventh Circuit specifically cited and then chose to override this holding. In *Tregenza v. Great American Communications Co.*, the Court stated that "Section 9(e), read literally, requires actual knowledge to set the statute of limitations running." 12 F.3d 717, 721 (7th Cir. 1993). A plaintiff must be aware of the facts that comprise the violation, "not merely enough facts to make a reasonable person suspicious and start looking for the facts constituting the violation." *Id.* The Court noted that § 13 of the Securities Act of 1933, 15 U.S.C. § 77m, amended by Congress on the same day it enacted § 9(e) of the 1934 Act, requires that an action be commenced "'within one year after the discovery of the untrue statement or the omission *or after such discovery should have been made by exercise of reasonable diligence*.'" *Id.* The Court explicitly stated that *Lampf* held that § 9(e), not § 13, provides the limitations period for Rule 10b-5 actions, but nevertheless decided that courts are "free to apply to the section the judge-made doctrine of inquiry notice" because "[n]othing in the language, history, or purpose of section 9(e) forecloses so modest and traditional an exercise of judicial creativity." *Tregenza*, 12 F.3d at 722.

In refusing to follow this Court's clear rejection of an inquiry notice standard, the federal appeals courts transform the "slight" difference in terminology between § 9(e) and § 13 into a significant burden for investors. These Courts have imposed a duty to investigate, effectively reducing the statute of limitations and creating the real potential that defrauded investors will be precluded from bringing meritorious claims. Under this standard, the one-year statute of limitations may be triggered before investors have actual knowledge of a claim, creating an imposing hurdle for the investor who fails to file a complaint within one year of the first sign of trouble.

This also creates a "Catch-22" for potential plaintiffs who will need to get to the court on time, but also will have to survive a motion to dismiss based on their failure to plead fraud with the particularity required by Fed. R. Civ. P. 9(b). This dilemma was exacerbated when Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C. (West 1997)). The PSLRA adopted strict new pleading standards, *see* 15 U.S.C.A. §§ 77z-1(a) & 78u-4, and requires that a court dismiss a complaint when the plaintiff fails to meet these heightened requirements, *see id.* § 78u-4(b)(3)(A). These new requirements place potential plaintiffs in a very real bind: they must prepare a highly detailed complaint within a very short time period. The PSLRA also provides for a stay of discovery while a motion to dismiss is pending. *See id.* §§ 77z-1(b) & 78u-4(b)(3)(B).

In its analysis of the first year of practice under the PSLRA, the SEC found a decline in the number of lawsuits against secondary defendants, which it attributed, in part, to the combined effects of the pleading standards, discovery stay, and short statute of limitations. Office of the General Counsel, Securities and Exchange Commission, *Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995* at 23-24 (Apr. 1997). According to the SEC, one factor

contributing to this decline may be the inability of plaintiffs' attorneys to conduct discovery which might reveal misconduct by secondary defendants. *Id.* at 24. Secondary defendants are not being named in initial complaints, and

> because complaints are customarily met with a motion to dismiss, discovery can be stayed for a year or more after the complaint is filed. The Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, however, requires that class actions under Section 10(b) of the Exchange Act be brought within one year from the date that the plaintiff discovered the alleged fraud. As a consequence, plaintiffs may find it difficult to name secondary defendants in either the original or amended complaints.

Id. (footnotes deleted).

Replacing the actual notice standard that this Court articulated in *Lampf* with an inquiry notice standard thus worsens what already is a serious problem for investors. It is not reasonable to increase this burden, which places thousands of individual investors, who do not have a basic understanding of financial terms, let alone the intricacies of the marketplace, at a distinct disadvantage.

B. Individuals Are Investing in the Securities Markets in Unprecedented Numbers, Often For the First Time.

Demographic factors have caused considerable changes in participation in this country's securities markets. In the past, wealthy individuals and corporations were the primary investors in the stock market. That is no longer true, due to the combined effect of the baby boom generation's entry into adulthood, changes in retirement regulations and strategies,

and a stock market that, for the most part, has been producing incredibly high returns. We have entered a period in which Social Security provides proportionately less of needed retirement income, and traditional employer-sponsored pension coverage has decreased. As a result, individual savings and investments are increasingly important and substantially at risk. Americans have departed, in unprecedented numbers, from their historic practice of placing primary reliance on federally-insured products, such as savings accounts and certificates of deposit, for their retirement needs.

Today, more than 28 million Americans over the age of 65 rely to some extent on investment income, other than bank accounts, to meet their expenses. *See* American Association of Retired Persons, Consumer Federation of America, and North American Securities Administrators Association, *The Five Biggest Problems "Legitimate" Investing Poses For Older Americans*, Background Report, March 1995, at 2; *see also* Securities and Exchange Commission, *Summary of Comments and Discussion Regarding Protections for Senior Citizens and Qualified Retirement Plans*, July 8, 1996, at 3. Recent data from the U.S. Census Bureau indicate that three-fourths of all seniors derive at least 25% of their income from investments, and 10% of older people depend on non-bank investments for at least 50% of their income. *See The Five Biggest Problems "Legitimate" Investing Poses For Older Americans*, *supra*, at 2, and SEC *Summary*, *supra*, at 3.

This phenomenon is not limited to older people. Americans of every age group are increasingly investing in the stock market, through individual investments, self-directed pension or other retirement plans and, indirectly, through mutual funds. A recent survey released by the NASDAQ Stock Market reported that stock ownership among the general public has doubled in the past seven years, from 21.1% of adult Americans in 1990, to 43% in 1997. A majority of the investors are under age 50, and one-half of

them do not have a college degree. *Number of Investors Has Doubled to 43 Percent in Past Seven Years Finds Comprehensive Shareholder Survey*, NASDAQ Stock Market 1 (Feb. 21, 1997), citing Peter D. Hart Research Assocs. for The NASDAQ Stock Market, *A National Survey Among Stock Investors* (Jan. 1997).

Commenting on record levels achieved on major stock exchanges, SEC Chairman Levitt also has noted the vast growth in individual investments:

> It is not surprising then that public participation in our securities markets has grown to record levels. Mutual fund assets ($135 million in 1980) are now a record $3.7 trillion, surpassing the $2.6 trillion that Americans have on deposit at commercial banks. As recently as 1980, only one in 16 households invested in mutual funds; today that number is more than one in three, as we have evolved from a nation of savers into a nation of investors.

Fraud In The Micro-Capital Markets, Including Penny Stock Fraud: Hearing Before the Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs, 105th Cong. 112, 113 (1997) (testimony of Arthur Levitt).

In this environment, Americans' investment income depends not merely on their ability to save, but also on their ability to invest wisely and safely. Unfortunately, that ability is not always within their control. In fact, stock market highs such as those we have recently enjoyed frequently are accompanied by increased, often difficult to detect, fraud. As Chairman Levitt recently stated:

> With this vast expansion in our markets and in public participation in those markets, we would expect to see an increase in the incidence of

> fraud. We have particularly seen an increase in abuses in the market for micro cap securities, which . . . provides opportunity for fraudsters to prey on innocent investors.

Id. at 114.

The Subcommittee Chair made a similar observation:

> We conduct these hearings against the backdrop of a booming stock market and a new generation of unseasoned investors. Hidden beneath the rising tide of the market, micro-cap fraud represents a pernicious undercurrent that potentially affects thousands of American families. Many of these families are, for the first time, investing their hard-earned money to save for skyrocketing tuition costs, unforeseen medical expenses, and lengthier retirements. While we have the safest and most successful capital markets in the world, the irony is that public confidence in our markets actually creates opportunities for con artists to exploit the unwary.

Id. at 55 (opening statement of Sen. Susan M. Collins).

Fraud is by no means limited to the micro-cap market. Rather, these hearing excerpts merely illustrate the problems faced by investors in many market sectors. More importantly, they underscore the importance of ensuring that investors subjected to these frauds have real access to the protections Congress provided for their benefit. This need is exacerbated by the relative lack of sophistication and high financial illiteracy of many investors who cannot realistically maintain the type of vigilance that the federal appellate courts require.

C. Individual Investors Have Extremely Low Levels of "Financial Literacy," Making Inquiry Notice Unreasonable.

Inquiry notice requires a determination of whether a plaintiff was alerted to facts which would cause a reasonable investor to investigate whether he or she had a claim. Rather than focusing on the underlying transaction and the merits of the claim, considerable resources will be spent debating whether certain factors should have placed a reasonable person on notice that something was amiss. The former Chairman of the SEC has warned that this "reasonable diligence" approach provides less clarity because of the difficulty in ascertaining whether someone should have discovered a fraud before he or she actually did. *See Securities Investor Legal Rights: Hearing on H.R. 3185 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 102d Cong. 22-25 (1991) (prepared testimony of Richard C. Breeden); *Securities Investor Protection Act of 1991: Hearing on S. 1533 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 102d Cong. 28-30 (1991) (prepared testimony of Richard C. Breeden); Letter from Richard C. Breeden to Sen. Pete Domenici, *reprinted in* 138 Cong. Rec. at S23479 (Aug. 12, 1992). Such a requirement "is unfair to fraud victims because almost every defendant can allege that a plaintiff 'should have' discovered a fraud earlier." *See* Letter from Breeden to Domenici, 138 Cong. Rec. at S23480. Moreover, this standard "would prompt a considerable amount of needless litigation to resolve subtle shadings of what an investor could or might have done." *Id.* The complexity of the marketplace and the relative lack of sophistication of a majority of individual investors make it extremely difficult for investors to know when a change in their account is due to normal market fluctuations as opposed to fraudulent activity.

SEC Chairman Levitt recently said that Americans are in the "midst of a financial literacy crisis." Arthur Levitt, Remarks Before the Consumer Federation of America, *Expanding the Promise of Opportunity and Security Through Savings and Investing* 2 (Dec 3, 1998). He added that

> [t]ens of millions of Americans lack the basic saving and investing information they need to prepare for retirement or to meet other financial goals. . . . While 63 percent know the difference between a halfback and a quarterback, only 12 percent know the difference between a load and a no-load mutual fund.

Id.

He also has indicated that "financial literacy has not kept pace with the growth of fund investments or investor satisfaction." Arthur Levitt, Remarks to the Investment Company Institute 1 (May 15, 1998). He cited SEC research which indicates that less than half of mutual fund investors know that fund expenses are deducted on an ongoing basis, and only 8% said they completely understand the expenses that their funds charge. *Id.* at 2.

Several recent studies conducted by government agencies, financial services corporations, and non-profit organizations have produced remarkable findings that bear out his concerns. The studies took different approaches but reached the same conclusion: individual investors lack even the most rudimentary knowledge needed to make informed investment decisions. Investors do not know the basics of how investments work, and they do not even know what they are doing with their own money.

For example, a May 1996 study conducted by the National Association of Securities Dealers (NASD) found that while 78% of Americans can name a character on a television

sitcom, only 12% know the difference between a load and a no-load mutual fund. National Association of Securities Dealers, Inc., *NASD Launches Major Public Disclosure, Investor Education Initiative* 2 (Feb. 19, 1997). A mere 14% of investors surveyed could tell the difference between a growth stock and an income stock. *Id.*

Other findings are equally troubling:[2/]

- Just one-half (49%) of investors know that stocks have offered a better return during the last thirty years than bonds, certificates of deposit, or Treasury bills. Consumer Federation of America & Nations Bank, *Planning for the Future: Are Americans Prepared to Meet Their Financial Goals?* 13 (Apr. 1997).

- Almost one-third of mutual fund investors incorrectly believe that bonds have historically provided the best protection against inflation. Only 24% know that the price of long-term bonds would be more likely than short-term bonds to fluctuate in response to interest rate changes. Ruth Simon, *We Put Investors to the Test -- and, Boy Did They Ever Flunk*, Money, Mar. 1998 at 37 (reporting on results of Money/Vanguard Mutual Fund Literacy Test).

- One-third (32%) of those who participate in a 401(k) or other retirement savings plan think there is no risk associated with bonds, and 14% think there is no risk associated with an

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[2/] All cited reports on file with American Association of Retired Persons, Wash., D.C.

investment in a "mutual fund" or a "balanced" fund. Towers Perrin, *Preparing For Retirement: A Survey of 1,000 Working Americans* 9 (Feb. 1995).

- Only 15.7% of mutual fund investors understand that higher expenses can lead to lower returns, with almost 20% believing that mutual funds with higher expenses produce better results. Gordon J. Alexander, et al., *Mutual Fund Shareholders: Characteristics, Investor Knowledge, and Sources of Information* 13 (Dec. 1997).

- Six in ten investors do not know that higher risk investments often carry higher commissions, and four in ten are unaware that their initial investment is lowered by the amount of a broker's commission. American Association of Retired Persons, *Investor Awareness of Broker Compensation Practices: Findings From An AARP Survey, Executive Summary* 3-4 (Apr. 1998).

- Nearly one-half (46%) of Baby Boomers who own stocks and one-third of those who own mutual funds do not know what rate of return they are earning on their investments. Among retirees, the numbers jump to 55% of stock owners and 48% of mutual fund owners. The Equitable Life Assurance Society, *The Equitable Nest Egg Study* 12, tbls. 1 & 2 (June 1996).

- Four in ten (39%) participants in 401(k) or other retirement savings plans do not know how their money is allocated among the major asset classes. Towers Perrin, *Preparing For Retirement*, *supra*, at 9.

The only conclusion to be drawn from this sampling of findings is that individual investors do not know the ABCs of investing. Lacking this basic knowledge of how the securities markets operate, and being unaware of the fundamental features of their own investments, they cannot reasonably be expected to know that factors associated with the performance of their investments should lead them to investigate whether they have been defrauded. They are even less likely to know that their failure to investigate will preclude them from suing to recover monies they have lost to fraud. Yet, this is the heightened burden erected by the federal Circuit Courts that apply an inquiry notice standard.[3/]

CONCLUSION

The common practice among federal courts of appeal to use an inquiry notice, rather than an actual notice, standard to trigger the statute of limitations for actions brought under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 is contrary to this Court's holding in *Lampf*. This practice is more than merely a "modest and traditional exercise of judicial creativity." *Tregenza*, 12 F.3d at 722. Rather, it seriously undermines securities law enforcement to the detriment of thousands of individual investors. The existing statutory and regulatory protections must not be weakened by the appellate court rulings, which effectively reduce an already short limitations period. Moreover, by imposing an inquiry notice standard, the lower courts also are placing an unreasonable investigatory burden on individual

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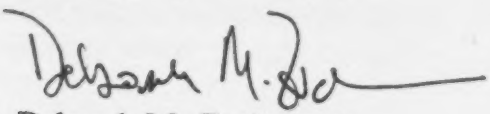
[3/] This untenable situation is exacerbated by what Circuit Courts consider adequate to place investors on notice. *See, e.g.*, *Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 610 (7th Cir. 1995) ("reasonable investor is presumed to have information available in the public domain . . . .").

investors, many of whom are unsophisticated with respect to the operations of the securities industry and the myriad of players and products involved in the market.

Amici respectfully urge this Court to grant a writ of *certiorari* in order to direct the lower courts to follow the clear language of this Court's mandate in *Lampf*.

Respectfully submitted,



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No. 98-799

In The
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1998

KAUTHAR SDN BHD,

Petitioner,

v.

MICHAEL A. STERNBERG, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONER'S REPLY BRIEF

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QUESTIONS PRESENTED

1. Whether the one-year statute of limitations period for private civil actions for damages under Section 10(b) and Rule 10b-5 as set forth in Section 9(e) of the Securities Exchange Act of 1934 begins to run from the time the victim of the fraud becomes aware that he or she is in fact a victim of fraud (*i.e.*, actual notice) rather than the time the victim becomes aware of facts that would lead a reasonable person to investigate whether he or she might have been a victim of fraud (*i.e.*, inquiry notice).

2. Whether a plaintiff's Section 10(b) and Rule 10b-5 securities fraud claims predicated upon several distinct and unrelated misrepresentations and omissions should be dismissed in their entirety with prejudice as time-barred under the one-year limitations period applicable to such claims when the plaintiff had notice of only one of the several misrepresentations and omissions underlying its claims more than one year prior to the time that it filed suit.

3. Whether this Court should exercise its supervisory powers and remand this case to the circuit court for consideration of the viability of certain state law securities claims because the circuit court rejected one of the grounds upon which the district court based its decision to dismiss those claims, expressly did not consider the other grounds, and nonetheless affirmed the district court's dismissal of those claims without addressing them or providing any basis in its opinion for sustaining their dismissal.

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A. The Circuit Courts Have Turned This Court's Decision In *Lampf* On Its Head. 1

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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1998

KAUTHAR SDN BHD, *Petitioner,*

v.

MICHAEL A. STERNBERG, *et al.*, *Respondents.*

Petitioner's Reply Brief in Support of its Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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I.

FACED WITH THE DIFFERENT STATUTES OF LIMITATIONS CONTAINED IN THE SECURITIES LAWS, THIS COURT EXPRESSLY CHOSE THE ACTUAL NOTICE STANDARD SET FORTH IN SECTION 9(e) OF THE SECURITIES EXCHANGE ACT OF 1934 TO GOVERN SECURITIES FRAUD CLAIMS BROUGHT UNDER SECTION 10(b) AND RULE 10b-5.

A. The Circuit Courts Have Turned This Court's Decision in *Lampf* on Its Head.

This Court chose Section 9(e) of the Securities Exchange Act of 1934 ("1934 Act") (15 U.S.C. § 78i(e)) as the applicable limitations statute for Section 10(b) and Rule 10b-5 claims. *Lampf, Pleva, Lipkind, Prupis & Petigrow v.*

Gilbertson, 501 U.S. 350, 364, n.9 (1991). The express language of Section 9(e) establishes an actual notice trigger for the running of the limitations period.

Nonetheless, following *Lampf*, federal circuit courts, including the Seventh Circuit, have refused to apply an actual notice standard in determining when the limitations period begins running on Section 10(b) and Rule 10b-5 claims. They have held that the limitations period begins running when the victim of securities fraud is put on inquiry notice of a violation.

The Respondents essentially concede that Section 9(e), on its face, does not contain an inquiry notice standard. However, they try to defend the circuit courts' application of an inquiry notice standard by arguing that Section 9(e) does not contain such a standard because Congress never intended Section 9(e) to govern fraud claims. This argument misses the point.

First, this Court specifically found that Section 9(e) "target[ed] the precise dangers that are the focus of § 10(b)." *Lampf*, 501 U.S. at 360. Moreover, the express language of Section 9(e) establishes an actual notice standard, and this Court adopted that Section's limitations period for Section 10(b) and Rule 10b-5 claims, recognizing that fact.

Indeed, this Court specifically chose the limitation period for Section 9(e) after considering a point made by the Securities and Exchange Commission (the "Commission") in its *Amicus Curiae* brief concerning the differences between that statute's limitations trigger and the trigger found in other securities statutes. The Commission explained:

> Section 9(e) of the 1934 Act provides a period of one year "after discovery of the facts constituting the violation," but no more than three years after "such violation." . . . Section 13 of the 1933 Act, in turn, provides still other variations for each of its express rights of action. In particular, claims under Sections 11 and 12(2)—*unlike claims under Sections 9*, 18, and 29 of the 1934 Act – must be filed within one year of actual or constructive discovery ("after such discovery should have been made by the exercise of reasonable diligence"). . . .

Brief for the Securities and Exchange Commission as *Amicus Curiae*, *Lampf*, 501 U.S. 350 (No. 90-333) (emphasis added; citations omitted). The Commission argued that "these variations can make a critical difference for the timeliness of any particular action . . ." *Id.*

This Court noted the distinctions to which the Commission pointed and expressly selected Section 9(e) as the governing limitations period. *Lampf*, 501 U.S. at 364 n.9 ("The Commission notes, correctly, that the various 1-and-3-year periods contained in the 1934 and 1933 Acts differ slightly in terminology. To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) the 1934 Act, 15 U.S.C. § 78i(e).").

By making this choice, this Court effectively rejected the inquiry notice trigger found in Section 13 of the Securities Act of 1933 ("1933 Act") (15 U.S.C. § 77m). This Court easily could have adopted an inquiry notice standard by stating that the limitations period begins "after such

discovery [of the untrue statement or omission] *should have been made by the exercise of reasonable diligence . . .*" 15 U.S.C. § 77m (emphasis added). However, it adopted the actual notice standard instead. This Court's decision should have been followed by the lower courts but has not been followed.

Legal precedent aside, application of an actual notice standard more strongly promotes the ends of justice. The policy argument set forth in *Tregenza v. Great American Communications Co.*, 12 F.3d 717 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994), to support an inquiry notice trigger, which the Respondents quote to support their position, protects the wrong party—the tortfeasor—at the expense of the fraud victim. In *Tregenza*, the Seventh Circuit espoused a view that the limitations period set forth in *Lampf* creates a "heads I win, tails you lose" situation for a victim of securities fraud because a victim theoretically could wait up to three years to see which way the market for his investment goes before filing suit. *Tregenza*, 12 F.3d at 722. While this may be true, neither the court in *Tregenza* nor the Respondents explain why the law should favor tortfeasors on this limitations issue rather than fraud victims. There is, after all, a three-year repose period to eliminate any threat that the victim will not act diligently to prosecute his or her claim.

The circuit courts and the Respondents seek to impose what is effectively a one-year repose period rather than the three-year repose period set forth in Section 9(e). In the Seventh Circuit, for example, the limitations period begins to run when the victim becomes aware of facts that would lead a reasonable person to investigate whether he or she might have a claim. *Tregenza*, 12 F.3d at 718, 721-22. In calculating this period, the Seventh Circuit applies its rule

that a "reasonable investor is presumed to have information available in the public domain . . ." *Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 610 (7th Cir. 1995). The net effect of this rule is to impute to the victim knowledge of all of the information available on the Internet and the World Wide Web, information on file with the Commission and all other governmental agencies, information contained in annual reports rarely received by investors and even more rarely read, and all other public information. The limitations period then begins to run when a reasonable person, who is unfairly presumed to possess this obscure and hard to find information, would have conducted a further investigation into the facts and thereafter learned of the fraudulent conduct.

As pointed out in the *Amici Curiae* brief of the American Association of Retired Persons and the Consumer Federation of America, this sort of sophistication, not to mention expertise in navigating the information superhighway, is simply too much to expect of the average investor. Yet, according to the rule being applied by many of the circuits, if the slightest evidence of abnormal investment performance exists somewhere in the deep recesses of the Internet or World Wide Web, then the one-year limitations period is triggered for all fraud claims related to that investment. In such a circumstance the victim more than likely would not even know of the fraud until well after the one-year limitations period has expired.

This cannot be the result intended by this Court when it decided *Lampf*. Victims of securities fraud must be given a fair shot at the courthouse to redress their claims. Justice is not served by protecting tortfeasors from actions filed by victims within one year of learning that they were defrauded.

B. This Court Should Address the Statute of Limitations Issue Raised in the Petition.

The Petitioner contested the dismissal of its Rule 10b-5 claims on statute of limitations grounds throughout the proceedings below. Moreover, the Petitioner specifically cited this Court's decision in *Lampf* in its briefs in the circuit court in arguing that its claims were not time-barred.

While the Petitioner did not specifically address below the distinction between actual and inquiry notice, that question is of significant enough importance to warrant this Court's review of the issue in this case. This is particularly so in light of the circuit courts' consistent failure to follow this Court's decision on that issue in the *Lampf* case.

The circuit court's application of an inquiry notice standard to determine when the statute of limitations began to run on the Petitioner's Rule 10b-5 claims constituted the kind of fundamental error that justifies this Court's review of a question not pressed below. *Sibbach v. Wilson & Co., Inc.*, 312 U.S. 1, 16 (1941). Moreover, the consistent misapplication of the law by the circuit courts on this issue and the interests of justice warrant consideration of the issue by this Court on this Petition. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1099 n.8 (1991) (an issue not considered below should be considered where it is "'"in a state of evolving definition and uncertainty,"' . . . and [is] one of importance to the administration of federal law.").

II.

FRAUD CLAIMS BASED UPON SEVERAL DISTINCT AND UNRELATED MISREPRESENTATIONS AND OMISSIONS SHOULD NOT BE DISMISSED IN THEIR ENTIRETY AS TIME-BARRED MERELY BECAUSE THE LIMITATIONS PERIOD MAY HAVE EXPIRED ON ONE ASPECT OF THOSE FRAUD CLAIMS.

This Court should examine whether fraud claims based upon several distinct and unrelated misrepresentations and omissions should be dismissed in their entirety as time-barred merely because a claim based upon one of those misrepresentations and omissions may have been time-barred. The Petitioner's securities fraud claims in this case arose from several separate and distinct misrepresentations and omissions made by the Respondents on several separate and distinct subjects. The district court in this case, however, chose to lump together all of those separate and distinct bases for the Petitioner's claim in determining that all aspects of all of the Petitioner's claims should be dismissed merely because the Petitioner was on inquiry notice of the falsity of one representation made by the Respondent more than a year prior to the time that it filed suit.

The district court justified its decision in this case by concluding at the pleading stage that the one misrepresentation of which the court concluded the Petitioner had inquiry notice more than a year prior to filing suit was a "critical component of [the Respondents] fraud." The circuit court accepted this aspect of the district court's decision in affirming the dismissal on appeal. However, the lower courts' analyses of this issue are flawed

Even if the Petitioner was on notice of the potential falsity of one representation made by the Respondents, the clock should not have started running on claims arising from completely unrelated misrepresentations and omissions of which the Petitioner had no notice of any potential falsity. The claims arising from misrepresentations and omissions of which the Petitioner was not on inquiry or actual notice should not have been dismissed as time-barred.

Considering the relatively short limitations period for bringing federal securities fraud claims—one year—the approach taken by the district court and circuit court in this case will lead to unreasonably harsh results, particularly if an inquiry notice trigger is applied. Under the approach taken by the courts in this case, victims of fraud would be forced to uncover all aspects of a fraudulent scheme, no matter how divergent and unrelated, and then prepare and file suit, all within a year.

This Court should intervene to protect victims of fraud from the effect of these unreasonably draconian rules. The interests of justice demand it.

III.

THE VIABILITY OF THE PETITIONER'S STATE LAW SECURITIES FRAUD CLAIMS SHOULD BE REVIEWED.

The Respondents completely mischaracterize the record with respect to the Petitioner's state law securities fraud claims. Contrary to what the Respondents say, the Petitioner specifically did ask the circuit court to reverse the district court's dismissal of those claims and did argue the viability of those claims on appeal. In addition, contrary to

what the Respondents say, the Petitioner has not contended that the circuit court should have decided to allow those claims to go to trial, although the Petitioner obviously would like to be able to bring its claims to trial. Tellingly, the Respondents fail to cite or reference anything in the record to support their assertions concerning the Petitioner's state law securities fraud claims.

The Petitioner seeks this Court's intervention because the appellate court failed to even consider the viability of the Petitioner's state law securities fraud claims in affirming the dismissal of those claims. The circuit court expressly rejected one of the bases for the district court's dismissal of those claims and it expressly did not consider the other grounds relied upon by the district court for dismissal. It appears as if the circuit court simply overlooked or ignored the Petitioner's state law securities fraud claims.

If the Respondent is suggesting that the Petitioner should have argued for different treatment of its state law securities fraud claims than its federal law securities fraud claims on the statute of limitations issue on which the circuit court affirmed dismissal of the Petitioner's federal law securities fraud claims, that argument makes no sense. The Petitioner's state law securities fraud claims were filed well within the three-year limitations period for such claims and no party or court ever has suggested otherwise. Therefore, there was no reason for the Petitioner to argue for separate treatment on that issue below.

This Court should intervene in this case to ensure that the Petitioner's state law securities fraud claims are properly considered by the circuit court before dismissal of those claims is affirmed. That never has been done. Ac-

cordingly, remand to the circuit court for consideration of the viability of those claims is appropriate.

CONCLUSION

This Court should grant the Petition so that it may disavow the practice of applying an inquiry notice standard to private civil actions brought under Section 10(b) and Rule 10b-5. Such a holding would require the reversal of the decision of the Seventh Circuit because the Petitioner filed this case within one year of being on actual notice of the Respondents' fraud. This Court also should grant the Petition to evaluate whether notice of one aspect of a fraud claim triggers the running of the limitations period for a claim based upon unrelated misrepresentations and omissions. Finally, this Court should grant the Petition so that it may remand this case for proper consideration by the circuit court of the plaintiff's Indiana state law securities fraud claims.

Respectfully submitted,

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